LIA

DEVELOPING
YOUR FUTURE
IN FINANCE

QFA Life Assurance

LEVEL 7

Certificate in Professional Financial Advice

Learning Resources

Core Resource - Your Textbook

Your textbook is the single most important study resource for your exam.

All sections of the textbook are examinable so it's essential that you study it thoroughly.

All other e-learning resources are designed to support the textbook and should only ever be used in conjunction with it.

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LIA provides you with a chapter weighting table which corresponds broadly with the minimum and maximum number of questions from each chapter that may appear on your exam paper.

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Test your knowledge and prepare for your exam by using 'Take a Test' to complete online sample exams.

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In your Study Hub, you will find LIAs 'The Advantage' factsheet which contains essential tax information related to your textbook.

Recommended Study: 130 hours

Steps to Success

Step 1

Getting Started

- Familiarise yourself with the e-learning resources provided in your Study Hub.
- Attend your Online Induction.
- Create a personalised study plan, considering the Chapter Weightings and the recommended study time.

Step 2

Textbook

- The textbook is your key resource and must be covered in its entirety.
- Pay particular attention to large chapters, see Chapter Weightings.
- Complete sample questions at the end of each chapter and revise any area you are not comfortable with.

Step 3

Pre-Recorded Lectures

- After reading a chapter, watch the corresponding pre-recorded lecture to reinforce your understanding.
- Listen to the pre-recorded lectures while on the go, allowing yourself every opportunity to study.

Step 4

Exam Preparation Masterclass

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- Ensure you've studied the textbook before the class for maximum benefit.

Step 5

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- These questions will not appear in the exam but will give you an indication as to how questions are presented online.
- Test yourself under exam conditions by completing a full exam within the allocated time frame.

Step 6

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- Ensure your laptop or desktop is set up correctly ahead of the exam.

The Education Team are with you every step of the journey and we wish you every success in your exam.

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QFA Life Assurance

2024/25 Textbook

Disclaimer

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Contents

01

Personal Financial Needs

Chapter 1 provides an overview of the main personal financial needs a client may have at different stages in their lifetime, with an explanation of generic types of life assurance policies which can meet those needs. An outline of the benefits to a client of financial planning is also included.

Learning Outcomes – after studying this chapter you should be able to:
discuss the main types of personal financial needs;
explain the general 'life cycle' of needs;
outline the various generic types of life assurance policies available to meet those needs; and
set out the benefits to a client of financial planning.

Chapter weightings	**Number of questions which may appear**		
In the exam, questions are taken from each Chapter based on the following approximate chart:	Chapter	Minimum	Maximum
	1	2	4

1.1 Main Types of Personal Financial Needs

All of us will have at any time, one or more personal *financial needs.*

Some of our financial needs may relate to a need to provide funds to replace earned income in certain eventualities.

Death	Illness	Retirement
Earned income stops	Earned income is reduced or stops	Earned income stops

Earned income is regular income obtained by working, such as wages and salaries from an employment and income from a self-employed trade or profession:

Earned income depends on continuing human effort, i.e., getting up and going out to work each day. Pension income is deferred earned income, i.e., earned income not taken at the time it was earned but invested and taken later in retirement.

Unearned income on the other hand, is income that comes from investments. The main types of unearned income are:

- Dividends/interest income from shares/bonds.
- Deposit interest.
- Rents from rental properties.

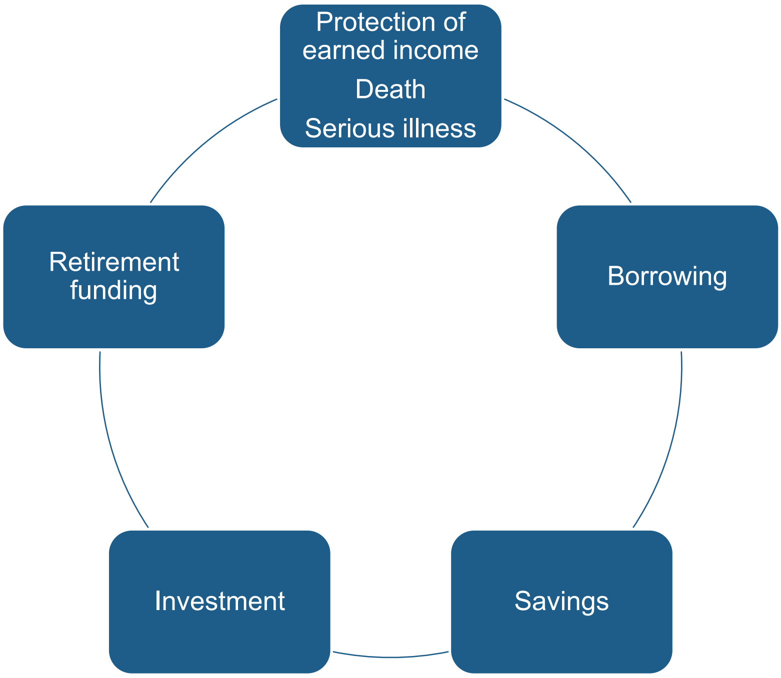
The important difference between these two different types of income is that earned income, stops very quickly if the client stops working. Unearned income, on the other hand, can be reasonably expected to continue whether the individual is working or not, for example, dividend income from shares would continue as long as the individual continues to hold the shares and the shares pay out dividends, even if the owner is ill and unable to work.

The need to replace earned income on death or serious illness are referred to as **protection needs**.

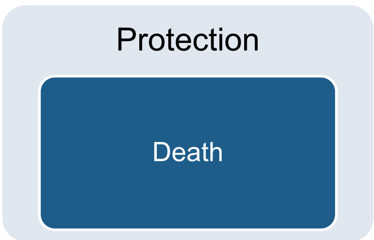
Other financial needs are related to borrowing, accumulating and investing capital for one or more specific financial purposes:

Savings	Investment	Borrowings
Accumulate a capital sum from regular surplus earnings over a period of time	Invest a capital sum not needed now to earn a return	Borrow capital to fund a purchase, for example, take out a mortgage to buy a home

Therefore, clients may have one or more of the following financial needs at different stages in their lifetime:



1.2 Examples of Personal Financial Needs



Jack and Aoife are married to each other, in their 30s, and have two young children. Both work and both earned incomes are needed to meet day-to-day living expenses and mortgage repayments.

If either dies, there will be a loss of their earned income to the household. They, therefore, have a need to provide funds to replace this earned income should either of them die while they are earning.

Paul and Sinead are married to each other, in their 30s, and have two young children. Both work and both earned incomes are needed to meet day-to-day living expenses and mortgage repayments.

If either of them develops a serious illness they may be off work for a prolonged period and have substantial medical expenses. There will be a reduction or possible total cessation of their earned income, for as long as they are unable to work normally.

They therefore may have a need to provide funds and/or a replacement income to replace their earned income if either of them develops a serious illness and becomes unable to work.

Borrowing

Mortgage to buy a home

Chloe is in her early 30s and has built up savings from earned income for a deposit to buy her first home.

She needs a mortgage to fund the balance required to buy her first home. She therefore has a borrowing need.

Savings

Accumulate a capital sum from earned income

Noel and Aisling have two young children in primary school. Both work. They have very little savings built up currently.

They want to start saving now from earned income to build up a fund to pay for sending their children to university in the future.

Investment

Invest a lump sum to earn a return

Catherine is in her late 50s and has just taken an early retirement deal from her employer.

She has received a lump sum of €97,500, after taxes. She wants to use €17,500 of this to pay off a car loan and some other expenses.

She wants to invest the balance of €80,000 to provide unearned income to replace some of her earned income.

Retirement

Provide a replacement income in retirement

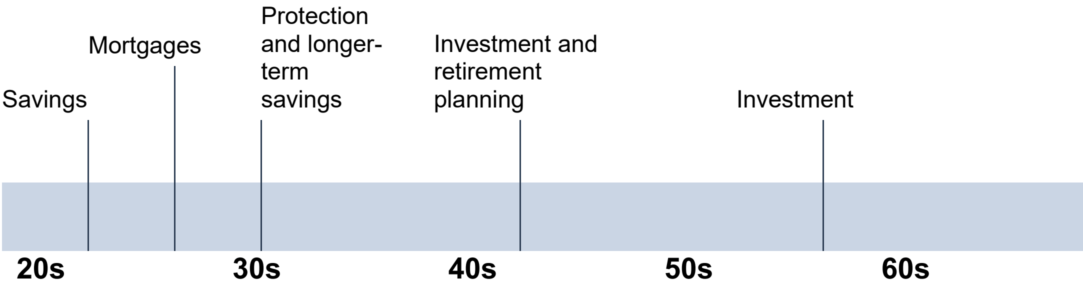
Dermot is self-employed and in his early 40s. He has no pension plan in place.

Dermot needs to start putting money aside now from his earned income to build up a fund to draw on later in retirement when he stops working.

Otherwise, he will only have the State Pension, currently a maximum of €277.30 pw, to fall back on in retirement.

1.3 Life Cycle

Personal financial needs generally change over time and hence vary by age. This is a generic timeline of typical changing financial needs:



Not one every client fits neatly into this pattern. Each client's financial needs and circumstances will be unique to them. As their lives change, so will their needs and goals, which demonstrates how important it is to review a client's financial needs on a regular basis.

For example, a single person with no partner or dependants may not currently have a need to replace their earned income on death, as no one else depends on their earned income to live on. But should they get married and have children within a few years, then a need now exists.

1.4 Life Assurance Policies to Meet Financial Needs

Life assurance companies offer different types of policies to consumers, providing different benefits to meet various financial needs:

Life assurance cover pays out a lump sum on the death of an individual insured by the policy, in return for a regular premium.

The lump sum could be used after death by next of kin in several ways:

- To pay off a mortgage or other loans;
- To invest and provide a replacement income for the deceased's next of kin;
- To pay taxes which may arise on death, such as Inheritance Tax.

Serious Illness cover, in return for a regular premium, pays out:

- A lump sum if the insured is diagnosed as developing one or more of the serious illnesses covered by the policy, such as cancer; and/or,

Sometimes life assurance and Serious Illness cover may be bundled into the one policy.

Income Protection cover, in return for a regular premium, pays out:

- A regular income that pays up to 75% of the insured's earnings, for as long as they are out of work due to sickness or disability lasting longer than a pre-defined period, such as, 13 or 26 weeks,

Savings plans

Accumulate a capital sum from earned income

A savings plan accumulates a capital lump sum over a period, recommended period is usually at least 10 years, in return for paying a regular contribution (sometimes referred to as a premium) to the plan, for example, €300 pm.

On death, the encashment value of the savings plan at that stage is paid out; sometimes the savings plan may pay out a minimum level of life cover on death, if this is more than the encashment value of the plan at death.

Investment bonds

Invest a lump sum to earn a return

Investment bonds invest a lump sum over a period, usually at least five years is recommended.

Only one contribution, also called a *single premium*, is paid into the policy. Such single contribution/premium investment policies are often referred to as *bonds* rather than policies.

On death, the then encashment value of the bond is paid out, but some policies may pay out a small bonus on top, e.g. some may pay out 101% of the encashment value on death.

Retirement

Provide a replacement income in retirement

Pension plans accumulate a retirement fund in return for a regular contribution and/or a once off or single contribution paid to the plan over a number of years.

There are different types of pension plans designed to suit different circumstances, such as Personal Retirement Savings Accounts (PRSAs) which are personally owned, and employer pension schemes arranged as a trust.

Pension plans are not covered in this Life Assurance module; rather they are covered in the Pensions module.

1.5 Benefits of Financial Planning

Personal financial planning is the process by which a consumer is helped by a personal financial adviser to identify and meet, as far as possible, their current and anticipated financial needs and objectives through the efficient management and use of their available financial resources and suitable financial products and services.

The financial planning process, if implemented properly with the benefit of professional competent advice, can benefit the consumer in several different ways:

- **It helps the consumer identify and prioritise their financial needs and objectives**; without the benefit of professional advice, some consumers may drift from a financial planning point of view, with no clear focus on their long-term financial needs and objectives.

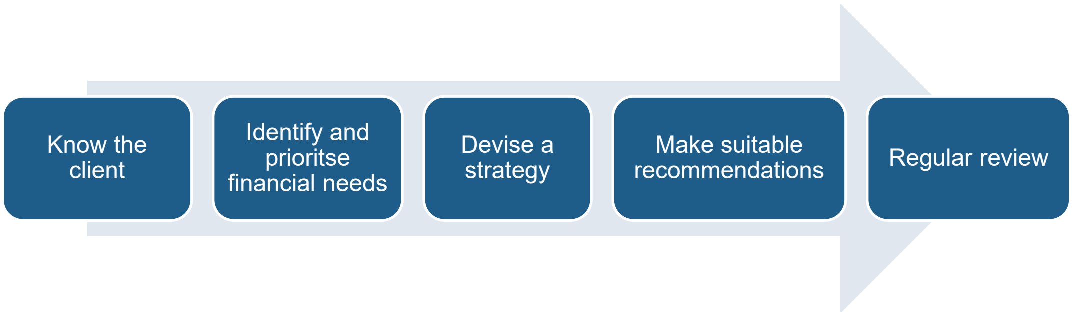
- **It helps the consumer to take a holistic or overall view of their financial circumstances and that of their dependants**, rather than the uncoordinated piecemeal approach adopted by some consumers, acting without the benefit of consistent professional advice.

- **It helps the consumer to make best use of their financial resources** by only buying and investing in financial products and services they need and are suitable to their individual circumstances. More specifically, clients will be advised to invest in savings and investment products which are appropriate to their attitude to and capacity for investment risk.

- **It helps the consumer achieve certain financial needs and objectives** which they might otherwise, in the absence of professional financial planning advice, fail to achieve or fail to achieve to the same extent.

- **Through regular reviews, the consumer's changing financial needs and objectives are identified,** and appropriate changes recommended to the consumer to stay on track in terms of meeting their financial needs and objectives.

- The whole process is to ensure that a client should be able to get through a 30 plus year retirement.



The provision of financial planning advice therefore involves five main stages:

- **Know the client,** i.e., accurately determine the consumer's current financial circumstances, including their financial needs and objectives.

  This process is sometimes also referred to as *fact-finding,* (i.e., the process by which the adviser finds out facts about the client's financial position).

- **Identify the client's financial needs, and prioritise them.**

  In some cases, the consumer may not be fully aware of all their financial needs and objectives; a fact-finding process may uncover various unfulfilled financial needs that clients themselves have not recognised fully, if at all.

- **Devise a strategy to meet the client's identified financial needs and objectives,** as far as is practically possible, taking account of the client's available financial resources, attitude to and capacity for investment risk, investment time horizon, the nature of their financial needs and objectives, and the proper use of suitable financial products.

- **Make suitable recommendations** to the consumer to meet, as far as possible, those identified unfulfilled financial needs within the available financial resources of the client.

- **Regular review**: a consumer's financial circumstances and needs will change over time, sometimes abruptly from unforeseen events like sudden illness or redundancy and other times more gradually over time.

  Therefore, any personal financial plan needs to be reviewed regularly to determine possible changes in the consumer's financial needs and objectives, and to verify if existing financial products and services continue to satisfy the consumer's needs in an efficient manner.

Review

Now consider the main teaching points, which were introduced in this Chapter. They are listed below. Tick each one as you go through them.

- The main types of personal financial needs ☐
- Examples of personal financial needs ☐
- The Life Cycle ☐
- Life assurance policies to meet personal financial needs ☐
- Benefits of personal financial planning ☐

Sample Questions

The answers to these questions can be found in your Study Hub.

1. A need to accumulate a capital sum from regular surplus income over a period of time is which type of personal financial need?

   A. Savings.
   B. Investment.
   C. Protection.
   D. Loan.

2. Which of the following is earned income?

   (i) Commission received by a salesperson.
   (ii) Credit union dividends.
   (ii) Interest on Government bonds.

   A. (i) only.
   B. (ii) only.
   C. (i) and (iii) only.
   D. (ii) and (iii) only.

3. The primary personal financial need of a typical couple in their early 30s with a young family is likely to be:

   A. savings.
   B. investment.
   C. retirement.
   D. protection.

4. Fact-finding is also known as:

   A. suitability.
   B. knowing the client.
   C. appropriateness.
   D. treating the client fairly.

02

Life Assurance Cover

Chapter 2 covers the different benefits, risks and charges associated with different types of life assurance policies providing a payment on death of the life assured, including Mortgage Protection, Term Assurances and Whole of Life cover. The various ancillary/optional benefits that are available on such policies are also examined in detail, including insurability options, terminal illness cover, hospital cash and waiver of premium. Finally, the Chapter looks at some restrictions which may apply to life assurance cover.

Learning Outcomes – after studying this chapter you should be able to:
explain the different types of life assurance policies providing a payment on death, including: - Temporary Assurances, Whole of Life cover, and ancillary/optional benefits; - the benefits, charges, and risks associated with each type of cover; and - typical restrictions and exclusions.

Chapter weightings	Number of questions which may appear		
In the exam, questions are taken from each Chapter based on the following approximate chart:	Chapter	Minimum	Maximum
	2	16	21

2.1 Introduction

Life Assurance cover pays out a lump sum on the death of the individual insured by the policy, called the **life assured**. In return, the **policyholder** (who legally owns the policy and is usually the same person as the life assured but can be different) undertakes to pay a specified regular premium to the life assurance company. The policyholder is sometimes referred to as the **owner**, as they are the legal owners of the policy the life company has issued.

There are two main types of life assurance cover policies:

Temporary assurance, which provide life assurance cover for a fixed period of time, referred to as the **term** of the policy. Hence such policies are referred to as ‘temporary’ or term assurances.

Whole of Life assurance, on the other hand, can provide life assurance cover throughout life. The cover does not automatically end at the end of a specified period of time, like Temporary Assurance cover.

2.2 Temporary Assurances

Temporary Assurances provide life assurance cover for a fixed period of time, called the **policy term**, usually at a fixed regular premium payable for the same term.

The policy ceases when either the end date of the policy is reached or an event which triggers a payout happens. At the end of the policy there is no cash return. Temporary Assurances therefore do not pay out any encashment or surrender value, if terminated; rather they are protection policies designed **solely** to “mature” (i.e. pay out a benefit) on the death of the life assured during the term of the policy.

There are five main types of Temporary Assurance policies:

- Term Assurance
- Convertible Term Assurance
- Pension Term Assurance
- Regular Income Benefit
- Mortgage Protection

We will now look at each of these types of Temporary Assurances in turn.

2.2.1 Term Assurance

The life company undertakes, in return for continued payment of a regular premium, to pay out a specified lump sum (called the **sum assured**) on the death of the life assured covered by the policy during the policy term. A Term Assurance policy never acquires a cash or surrender value.

Cover ceases at the end of the policy term, or earlier if the policyholder stops paying premiums. If the policyholder wants to continue the cover when the policy term ends, he or she will have to apply for a new policy at that stage.

The policy term can be chosen from one year, upwards to maybe 40 or 50 years, depending on the range of policy terms offered by a life company. Most life companies have an upper ending age for Term Assurance cover, typically 80 or 90.

The regular premium is fixed at the outset and will vary according to the:

- **Level of life assurance cover required**; the higher the cover required, the higher the premium.
- **Policy term**; the longer the term of cover, the higher the premium for the same level of cover; this reflects the fact that the longer the period of cover, the higher the risk of the life assured dying, as the risk of death increases with age.
- **Age of the life assured**; the older the life assured is at the start of the policy, the higher the premium.
- **Smoker/non-smoker status of the life assured**; Smokers are found to have a higher risk of dying over a given period than non-smokers of the same age, and so are charged more for the same cover and term than for non-smokers. This reflects the proven link between smoking and serious illnesses such as heart disease and cancers leading to death.
- **Health status of the life assured**; while over 90% of lives assured are usually insured at **ordinary rates***,* a small proportion may be offered cover only at an increased or loaded premium over the normal or ‘ordinary’ premium because of a likely higher risk of claim. A very small number of cases may be **declined** by the life assurance company, i.e., the company refuses to offer them life assurance cover as the life company estimates the risk of death during the policy term is too high and uncertain to be insured.
- **Occupation of the life assured**; Some occupations which contain a higher risk of death; for example, a window cleaner may be charged a higher premium than someone in a lower risk manual occupation or, in some cases, may be declined cover altogether.

- **Ancillary or rider optional benefits, if any**, chosen; for example, an indexation option might be added to the policy, in return for a higher premium, which will increase the cover and premium during the policy term to keep the cover broadly in line with inflation, even if the life assured's health deteriorates.

For policies issued before 21st December 2012 the premium did vary by gender with males paying more for the same life assurance cover than females of the same age. For new policies issued after that date, men and women are charged the same premium for the same cover over the same term.

Example #1

Take a consumer aged 35 who needs €250,000 life assurance cover for up to 25 years. This is called **single life** cover as the policy covers one life assured only.

Currently one life company charges these monthly premiums for €250,000 life assurance cover:

Term of cover	Non-smoker	Smoker
15 years	€17.19 pm	€29.01 pm
25 years	€20.91 pm	€37.75 pm

Note the significantly higher premium for the same cover over the same term for a smoker.

A Term Assurance policy can insure two lives, paying out on the *first* of the two lives assured to die during the policy term. This is called **joint life** cover.

Example #2

Take a consumer and their spouse both aged 35, who need €250,000 life assurance cover for up to 25 years, to be paid out to the survivor on the death of the *first* of them to die during this period.

Currently one life company charges these premiums for €250,000 *joint life* cover for 25 years:

Both non-smokers	Both smokers
€37.09 pm	€68.76 pm

If one of the lives assured above dies during the policy term, the €250,000 cover is paid out to the survivor and the policy ends. There is no cover left on the survivor.

A different type of cover on two lives is where a *separate* sum assured is payable on the death of each life assured during the policy term. This is called **dual life** cover. It's like two single life policies combined into one.

A **joint life** Term Assurance policy pays out the sum assured **once**, on the death of the *first* to die during the policy term.

The policy ends on the death of the first to die.

Example #3

Take a consumer and their spouse both aged 35, who need €250,000 life assurance cover on each of their lives for 25 years. They take out a **dual life** Temporary Assurance policy for 25 years.

Let's call them A and B. Let's say A dies first during the policy term.

€250,000 cover on A is paid to the survivor B, who can continue the policy with their own €250,000 cover. If B continues the policy and dies later, during the term of the policy, their €250,000 cover is paid to their estate.

Therefore, if both died at different times during the policy term of a dual life policy with €250,000 cover on each life, a total of €500,000 will be paid out.

Currently one life company charges these premiums for €250,000 **dual life** cover for 25 years:

Both non-smokers	Both smokers
€37.81 pm	€70.17 pm

Note that the cost of dual life cover in this example, is only marginally higher than similar joint life cover, over the same term. Assuming both are non-smokers:

- Joint life cover premium: €37.09 pm.
- Dual life cover premium: €37.81 pm.

In dual life cover, different levels of life assurance cover can be chosen on each life assured; the cover doesn't have to be the same on each life.

Example #4

Take a consumer, A, and their spouse, B, both aged 35, who need €250,000 life assurance cover on A and €100,000 cover on B for 25 years. They take out a **dual life** Temporary Assurance policy for 25 years, with cover of €250,000 on A and €100,000 on B.

If A dies first, €250,000 is paid out to B, who can continue the policy with their own €100,000 cover. If B dies later during the policy term, their €100,000 cover is paid out to their estate.

So, if both die at different times during the policy term, €350,000 in total will be paid out.

Currently one life company charges these premiums for **dual life** cover of €250,000 on one life assured and €100,000 on the other life, for 25 years:

Both non-smokers	Both smokers
€27.40 pm	€50.13 pm

A life company may have a **minimum premium**, typically between €10 and €20 pm, so that they will not, for example, issue a policy at a premium level less than the specified minimum premium.

Example #5

Take a consumer aged 35, a non-smoker, who needs single life assurance cover for 25 years.

Currently one life company charges these premiums for different levels of cover for 25 years for a 35-year-old, non-smoker:

Cover	Monthly premium
€100,000	€15.15*
€150,000	€15.15*
€200,000	€17.23
€250,000	€20.91

**This life company's minimum monthly premium for a Temporary Assurance policy.*

In the example above, the consumer who needs €100,000 cover might as well go for €150,000 cover as he or she will pay the same monthly premium, i.e., €15.15 pm, this life company's minimum monthly premium.

If the life assured does not die during the policy term, at the end of the Term Assurance policy term:

- The policy and cover end with no further benefit.
- There is no encashment or surrender value.

If there is a need for continuing life cover, the consumer must apply to a life assurance company at that time.

If they develop a serious medical condition during the policy term, they may not be able to get new life cover at all at the end of the policy term or only get it at a significantly increased premium compared to the cost for a normal life assured at that time.

This is therefore a risk with Term Assurance that the consumer needs to extend the cover beyond the policy term but is unable to do so because their health has deteriorated since they originally took out the policy and they may not be able to get cover at all at that time, or only get it at a prohibitive cost.

2.2.2 Convertible Term Assurance (CTA)

Convertible Term Assurance (CTA) is the same as Term Assurance but in return for an small additional premium it provides an additional benefit, a **conversion option**, i.e., the right to convert or transfer the cover at any time during the policy term into a new policy running for a longer period, without the need for any medical evidence regardless of the life assured's state of health at the time of conversion. For example, the cover can be transferred to the new policy, even if the life assured is in bad health at that time and would otherwise be uninsurable.

On exercise of the conversion option, the premium the policyholder will have to pay for the new policy will be based at that time on several factors:

The level of cover on the new policy

- The conversion option can usually be exercised up to the level of cover on the old policy, but can be taken up for a lesser amount of cover.

The life assured's age at the time of conversion

- Where the life company originally accepted the life assured under the Convertible Term Assurance policy at ordinary rates, it will assume at conversion into the new policy that the life assured is still a ‘normal’ or average life, even if the life assured's health has actually deteriorated in the meantime.

The life company's premium rates at that time

- Conversion into a new policy will be at the life company’s ordinary rates ruling at the time of conversion, for that type of new policy, cover and based on the life assureds ages at the the time of application. The policyholder has no guarantee in advance on the level of premium he or she will have to pay on the new policy for the extended cover.

If the policyholder doesn’t exercise the conversion option during the Convertible Term Assurance policy term, the life cover ceases at the end of the policy term without any benefit, just like Term Assurance.

Example

Just under 10 years ago, Joe took out a Convertible Term Assurance policy for €100,000 life cover for a 10-year term on his own life. He was in good health at that time and was accepted by the life company at normal rates.

The policy will expire in three months. He has just been diagnosed as suffering from a serious form of cancer and is undergoing treatment.

He can exercise his conversion option to take out a new policy at normal rates to extend the €100,000 life cover for a further period. The life company must accept his proposal for the new policy at the normal premium rates they are charging for new policies at that time. They cannot ask him to go for a medical or refuse him cover because of his reduced life expectancy.

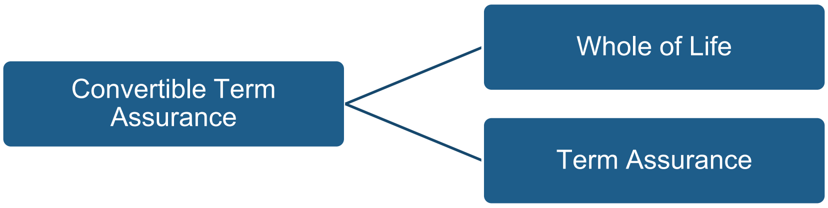
However, had Joe taken out Term Assurance 10 years ago, instead of Convertible Term Assurance, his cover would cease in three months’ time on expiry of the 10-year term. He would not now be able to take out a new policy for €100,000 life cover because no life company would be likely to accept his proposal at this time, due to his uncertain future life expectancy.

Frequently there may be an upper age limit, for example, life assured’s 70^{th} or 75^{th} birthday, at which the conversion option expires even if this is still within the term of the Convertible Term Assurance policy.

The details of the conversion option vary from life company to life company and from policy to policy, but usually the option allows the conversion up to the amount of cover on the Convertible Term Assurance policy at that time into:

- A **Whole of Life policy** which, as we shall see below, is a policy which can provide cover throughout life; and/or

- Another **Term Assurance policy,** *without* a further conversion option, for a term not exceeding a certain specified age, for example, the life assured's 75th or 80th birthday.



The extra cost for Convertible Term Assurance compared with Term Assurance for the same cover and term, is typically about 5%-10% of the premium, depending on age and smoker status.

The life company will charge for the extra claims that it will expect to pay out because of the conversion option, i.e., as it is likely that more 'bad lives', i.e., lives with a reduced expectation of life, will take up the conversion option than good lives.

This table below shows typical premiums for €250,000 single life, life assurance cover, over 25 years for a 35-year-old:

Typical monthly premium

	Term Assurance	Convertible Term Assurance
Non-smoker	€20.91	€22.22
Smoker	€37.75	€40.17

Convertible Term Assurance costs more than corresponding Term Assurance because of the extra benefit it provides, i.e., the right to extend the cover in the future into a new policy at normal rates even if the life assured is then in bad health.

Good lives at the time of conversion, i.e., those with an average expectation of life, may be able to get fresh cover with another life company at cheaper normal rates than through exercising their conversion option with their current life company.

2.2.3 Pension Term Assurance

Pension Term Assurance is Term Assurance which can be taken out by the self-employed and employees in non-pensionable employment, where the premium qualifies for income tax relief at the consumer's marginal rate of income tax, within certain limits.

Pension Term Assurance premiums may qualify for income tax relief, within certain limits.

Example #1

Fatima is self-employed and needs €250,000 life assurance cover to protect her dependants should she die. She is aged 40, a non-smoker, and wants cover for 20 years.

If she takes out a Term Assurance policy, the monthly premium might be €26.16 pm. This premium does not qualify for income tax relief.

If instead she took out a Pension Term Assurance policy for the same amount and term, the premium might be the same at €26.16 pm, but she could claim income tax relief on it at her marginal income tax relief, within certain limits:

	Term Assurance	Pension Term Assurance
Monthly premium	€26.16	€26.16
Less income tax relief at, say, 40%	-	€10.46
Net cost	**€26.16**	**€15.70**

The limits and restrictions on the income tax relief provided on Pension Term Assurance premiums are as follows:

- The maximum total pension contributions and Pension Term Assurance premiums for which income tax relief can be claimed in any one year by an individual is limited to a percentage of their earnings for that year, varying by their attained age in that year:

Age attained in year	Maximum percentage of earnings which can be claimed in pension tax relief
Under 30	15%
31 to 39	20%
40 to 49	25%
50 to 54	30%
55 to 59	35%
60 and over	40%

- The maximum earnings which can qualify for income tax relief on pension and Pension Term Assurance premiums paid in a year is €115,000.

Example #2

Olive is a self-employed dentist. Her earnings from her profession in 2024 are €90,000 say. She is aged 44 in 2024.

She is already paying €12,000 pa to a Personal Retirement Savings Account (PRSA) to build up a pension for herself. The maximum additional pension and Pension Term Assurance premiums for which she can claim income tax relief in 2024 is:

25% x €90,000 less €12,000 = €10,500.

Example #3

Jakub is a self-employed solicitor. His earnings from his profession in 2024 are €145,000 say. He is aged 52 in 2024.

He is already paying in €20,000 pa to a Personal Retirement Savings Account (PRSA) in 2024. The maximum additional pension contributions and Pension Term Assurance premiums for which income tax relief can be claimed by Jakub in 2024 is:

30% x €115,000 less €20,000 = €14,500.

In this example, the earnings for tax relief purposes are limited to €115,000.

There are also some **restrictions** on Pension Term Assurance cover as compared with an ordinary Term Assurance cover:

Pension Term Assurance	Other Term Assurances
• Single life only. • Life assurance cover only. • Maximum term to age 75. • Can not be assigned as security for a loan; on death the proceeds must be paid to deceased's estate.	• Can be single life, joint life, or dual life. • Life and/or Serious Illness cover. • No statutory maximum term. Some life companies may offer cover to 80 or 85. • Can be assigned as security for a loan.

Pension Term Assurance is also sometimes known as **Section 785** cover, after a section of the Taxes Consolidation Act which grants income tax relief on such premiums.

It is worth noting that while it works well in terms of making the life assurance cheaper, it may affect the clients funding for their retirement as it restricts the amount, they can put into a pension, based on the above criteria.

2.2.4 Regular Income Benefit

So far, we have looked at Temporary Assurance policies which pay out one *lump sum* on death.

However, some life companies offer Temporary Assurances which on death pay out a regular payment, for example, €2,000 pm, for the balance of the policy term. This type of Temporary Assurance is sometimes referred to as a **regular income benefit** policy.

Example #1

Mr A effects a Regular Income Benefit Term Assurance for a 20-year term, for a benefit of €2,000 pm. He dies after six years, i.e., with 14 years to go to the end of the policy term.

The policy would pay out €2,000 pm for the remaining 14-year term of the policy, i.e., total pay-out over the remaining 14 years of the policy term of 14 x 12 x €2,000 = €336,000.

These regular payments are treated as instalments of life cover and are NOT liable to income tax in the hands of dependants, despite the policy sometimes referring to the cover as an *income* benefit.

Most Regular Income Benefit policies also offer, on death, the option of taking an immediate discounted capital sum in lieu of the instalments for the remaining term of the policy.

Example #2

Mr A effects a Regular Income Benefit Term Assurance for a 20-year term, for a benefit of €2,000 pm. He dies after six years, i.e. with 14 years to go on the policy term.

The policy will pay out €2,000 pm for the remaining 14-year term of the policy, i.e., total pay-out over the 14 years of €336,000.

As an alternative, the life company may be prepared to offer an immediate capital lump sum representing the discounted value, at that stage, of the €2,000 pm for the 14-year period, say €300,000, instead of paying out the €2,000 pm benefit for 14 years.

Effectively a Regular Income Benefit Term Assurance is a form of **Decreasing Term Assurance**, as the potential pay-out under the policy decreases with each passing year, eventually reducing to nil by the end of the policy term.

Example #3

Mr A effects a Regular Income Benefit Term Assurance policy for a 20-year term, for a benefit of €2,000 pm.

If he dies after 6 years, 14 x 12 = **168** monthly instalments of €2,000 will be paid out over the remaining 14 years.

However, if he died after 12 years, 8 x 12 = **96** monthly instalments of €2,000 will be paid out over the remaining 12 years.

But if he died after 16 years, just 12 x 4 = **48** monthly instalments of €2,000 will be paid out over the remaining 4 years.

The maximum potential pay-out starts at 20 x 12 x €2,000 = €480,000 (spread over 20 years) and decreases by 12 x €2,000 or €24,000 each year, reaching nil by the end of the 20-year policy term.

2.2.5 Mortgage Protection

Mortgage Protection is a form of Term Assurance which pays out a lump sum on death within the policy term, estimated to be sufficient to pay off the estimated balance of a mortgage at that time.

The cover reduces each year in line with the anticipated reduction in the outstanding mortgage; it is therefore **Decreasing Term Assurance,** unlike normal Term Assurance where the cover remains level or increases but does not fall over the policy term.

Borrowers taking out a capital and interest mortgage (also known as a *repayment* or *annuity mortgage*) in respect of their principal private residence (referred to as *home loans*) will usually be required by their lender to take out Mortgage Protection cover to clear off their mortgage should the borrower die during the mortgage term, before the mortgage has been fully repaid.

In this way, the borrower's dependants will, following their death, own the residence in full, without any outstanding mortgage.

The cover is set at the start equal to or in excess of, the initial mortgage amount. The policy term will be the same as the anticipated mortgage term, i.e., typically 25 or 30 years.

By the end of the mortgage term the cover will have decreased to zero as the mortgage is assumed to be then fully repaid to the lender, assuming all mortgage repayments have been made on time.

Mortgage Protection is a form of **Decreasing Term Assurance**. The cover provided decreases each year.

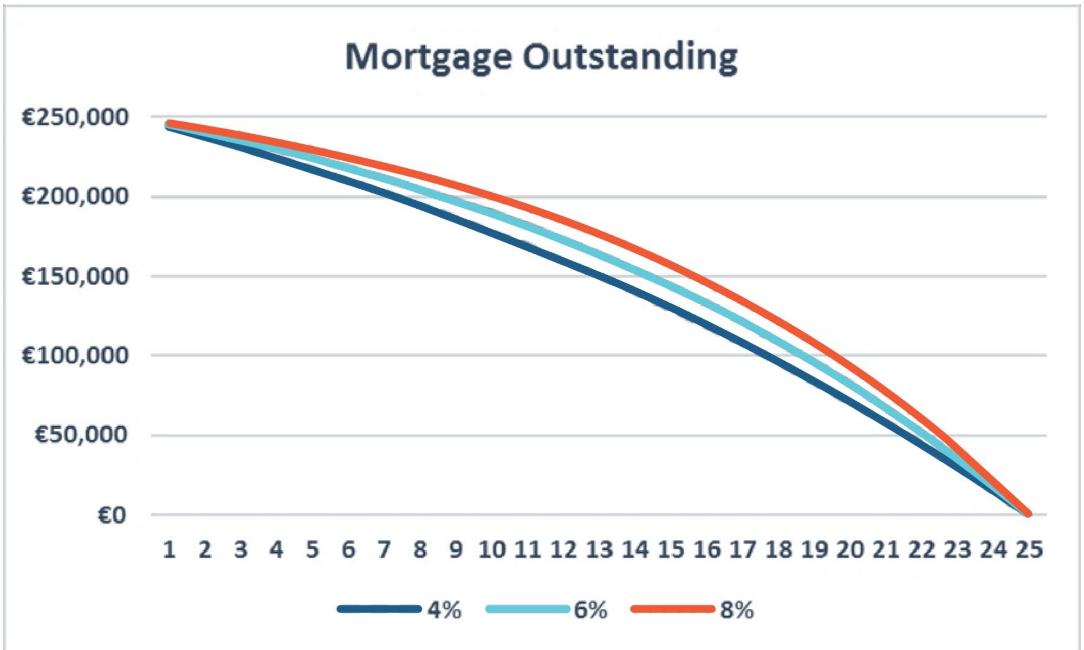
With a variable rate mortgage, no one can predict in advance what the mortgage interest rate will be from year to year, and hence what the capital outstanding will be at any time during the mortgage term.

To err on the safe side, Mortgage Protection policies generally anticipate a high mortgage interest rate, say, 6% pa, and so if mortgage interest rates do not increase above this level, the level of Mortgage Protection life cover will always be at least sufficient to pay off the mortgage at death; indeed, there may be some funds left over after repaying the mortgage.

Other policies may allow the individual to choose the level of mortgage interest rate and the Mortgage Protection life cover from year to year will be based on the assumed mortgage interest rate chosen.

The higher the assumed mortgage interest rate assumed, the higher the Mortgage Protection premium becomes as more cover is provided over the policy term.

For example, this chart shows the estimated mortgage balance outstanding on a 25-year capital and interest mortgage of €250,000, based on three different assumed mortgage interest rates applying over the mortgage term:



You can see from the above that while all three policies start with the same cover of €250,000 and end after 25 years with no cover, the 8% mortgage interest rate has a higher mortgage outstanding and hence more life over is required during the mortgage term, than the 6% rate, which in turn is higher than the 4% rate.

Example

Take a couple aged 35 (both non-smokers) who borrow €250,000 from a bank over 25 years on a capital and interest mortgage. These are the premiums currently charged by one insurer for Mortgage Protection cover over 25 years:

Assuming mortgage interest rate of	Mortgage Protection premium
6% pa	€25.63 pm
8% pa	€27.56 pm

In this example, the minimum mortgage interest rate the insurer normally assumes is 6% pa but the borrower can opt to choose a higher rate of 8% if they are happy to pay a slightly higher premium in return for slightly higher cover during the mortgage term.

If the mortgage interest rate actually charged over the mortgage term transpires to be lower than assumed by the Mortgage Protection policy, there may be a surplus for the next of kin on death after repaying the mortgage, because the outstanding mortgage on death will be slightly lower than the lump sum paid out by the policy on death.

If the mortgage interest rate charged over the period transpires to be higher than assumed by the Mortgage Protection policy, there will be a shortfall to be made up by the next of kin to fully pay off the mortgage on death as the Mortgage Protection policy will not fully pay off the mortgage.

Individual Mortgage Protection policies are therefore said to be **interest rate sensitive,** i.e., the cover varies by the mortgage interest rate assumed and is therefore not necessarily guaranteed to pay off the mortgage in full, as the cover is *sensitive* to, or based on, an *assumed* average mortgage interest rate applying over the mortgage term; the actual mortgage interest rate charged could turn out to be higher or lower than this assumed rate.

A Mortgage Protection policy is usually **assigned** to the lender as security for the mortgage; this means legal ownership of the policy is transferred to the lender, who is then entitled on death of the borrower to claim the sum assured from the life company and use the funds to pay off the outstanding mortgage. Any surplus from the Mortgage Protection policy left over after repaying the mortgage is payable to the deceased's next of kin.

If a consumer moves their mortgage from one lender to another, the Mortgage Protection policy assigned to the first lender will be released back to them when the first lender is fully repaid by the second lender; in this case the individual can reassign the policy to the second lender. Therefore, a borrower can bring his or her Mortgage Protection policy with them if they change lenders.

Where a borrower takes out individual Mortgage Protection cover, they can choose whatever life company and/or insurance intermediary they wish to use.

2.2.6 Group Mortgage Protection

Most lenders offer home loan borrowers the option to take out Mortgage Protection cover under a **group policy** arranged by the lender, i.e. one policy owned by the lender which insures many of its home loan borrowers.

The premium for each borrower's group Mortgage Protection cover is payable by the borrower to the lender with their monthly mortgage repayments. The lender then pays the life assurance company the premiums in bulk each month or possibly yearly.

On death, the insurer pays the cover to the lender, who then uses it to pay off the mortgage.

Group Mortgage Protection cover is usually not interest rate sensitive, i.e. the cover pays out the full outstanding mortgage on death regardless of the pattern of mortgage interest rates, provided the borrower has made all repayments when due. Group Mortgage Protection cover may also cover to some limited extent arrears, where borrowers had fallen behind on their mortgage repayments before death.

As the Group Mortgage Protection cover is arranged and owned by the lender, the borrower has no right to choose the life company or type of policy and cannot bring the cover with them if they move to a different lender.

2.2.7 Payment of Premiums

A life assurance policy is a **legal contract** between the life company and the policyholder under which:

- The policyholder undertakes to pay the premiums set out in the policy; and,
- The life company in return undertakes to pay out benefits set out in the policy in the circumstances as specified in the policy, for example, to pay out the sum assured if the life assured dies during the policy term.

A client might stop paying premiums under a Temporary Assurance policy, for different reasons:

- The direct debit from the life company bounces, as the account was overdrawn on the day the debit was presented to the bank by the life company, i.e., insufficient funds.
- The client decides to stop paying premiums and cancels their direct debit or refuses to pay any more premiums. This might happen where the client is under financial stress at that time, for example, lost their job, or maybe feels they no longer need that particular policy or cover, or they have arranged suitable replacement cover under another policy.

Most Temporary Assurance policies offer 30 **days of grace** to pay the premium, i.e., the cover continues during this period even though the premium due was not paid.

If there is a death claim within the days of grace, where the last premium due was not paid, the life company would typically pay out the sum assured less the premium due and unpaid.

Example

Yusuf has a 20-year Term Assurance policy for life cover of €100,000 at a monthly premium of €35.

The premium is due each month on the 5^{th}. On 5^{th} of January 2024, the direct debit is presented by the life company to the bank but is returned unpaid due to insufficient funds.

Yusuf dies in a car accident on the 7^{th} of January 2024. If the policy conditions provided for 30 days of grace for payment of premiums, the policy was still in force on the 7^{th} of January and hence the life company would pay out €100,000, the sum assured, less €35 (the outstanding premium), i.e., €99,965.

If the premium due has not been paid after the expiry of the days of grace, the Temporary Assurance policy **lapses** at the end of the grace period without benefit and the cover is cancelled.

However, some insurers may allow the policy to be **reinstated** within another short period, say, 30 days after the expiry of the days of grace, subject to the completion by the life assured of a Declaration of Health, showing that they are in good health, and subject to payment of outstanding premiums.

2.2.8 Temporary Assurance Charges

Temporary assurance policies charge the policyholder a fixed premium for a fixed amount of cover, payable for the term of the policy. The premium allows for:

- The life company's anticipated cost of claims.
- The life company's administration costs of establishing and maintaining the policy, including intermediary/sales remuneration payable in relation to the policy.
- A profit margin for the life company.
- The 1% insurance premium levy payable to the Government.

Temporary assurance does not usually, therefore, have **explicit** or visible charges; all charges are bundled into the premium payable, which pays for the cover and charges.

However, some Temporary Assurance policies may charge a fixed policy fee, for example, €3 pm, on top of the regular premium as an administration fee.

Example

A life company quotes a monthly premium rate of €0.10 pm per €1,000 of Term Assurance cover, for a particular age and term of cover. The company also charges a fixed policy fee of €3 pm, regardless of the level of cover and premium payable.

Joe proposes for €300,000 of Term Assurance cover. His monthly premium is calculated as:

€300 x €0.10 + €3 = €33 pm, plus the 1% insurance premium levy =

€33.33 pm.

If Joe has proposed for €400,000 of Term Assurance cover, his monthly premium would be:

€400 x €0.10 + €3 = €43 pm, plus the 1% insurance premium levy =

€43.43 pm.

2.2.9 Benefits of Temporary Assurances

The benefits Temporary Assurances provide to the consumer are:

- **Premium and cover are predictable and fixed for the policy term**. For the consumer, it's a 'fixed price' deal.
- **Life cover at an economical cost, as cover can be bought just for the anticipated period of maximum need.** For example, a young couple with young children might need a high level of protection cover until the children are likely to be financially independent; hence cover can be bought for this anticipated period of maximum need.
- **If the consumer can't afford the premium required to provide cover for the full anticipated period of need, they can get the same cover for a shorter term at a cheaper cost now**, with a view to extending the cover later for a further period at an increased cost.

For example, this table shows the monthly premium currently being charged by one life company for €300,000 Convertible Term Assurance for a life assured aged 35 next, non-smoker, over different policy terms:

Term	Monthly premium
20 years	€22.22
15 years	€20.12
10 years	€18.54

The consumer could buy the €300,000 required cover now for 10 years, with a conversion option, at just €18.54 pm, but with the option to extend the cover later one for a longer period at an increased cost.

- Because benefits and premium are guaranteed for the policy term, **competing Temporary Assurance policies can be easily compared where they provide the same benefits**, and hence the most suitable policy (usually the cheapest premium) can usually be easily identified.

Example

John needs €500,000 life assurance cover for 20 years.

Life Co A has quoted a fixed premium of €43.04 pm for the €500,000 Temporary Assurance life cover for 20 years.

Life Co B has quoted a fixed premium of €41.05 pm for the €500,000 Temporary Assurance life cover for 20 years.

All other things being equal (for example, that the financial standing and claims payment histories and underwriting requirements of each life company are not materially different in John's case), the policy from Life Co B is the most suitable for John, as it provides the same cover for the same term but at a cheaper cost than Life Co B.

2.2.10 Risks of Temporary Assurances

While Temporary Assurances provide cover in return for a fixed premium over the policy term, Temporary Assurances carry some potential risks for the consumer:

- **If the cover is not increased regularly, its real purchasing power will reduce over time due to the effects of inflation.**

  For example, this table shows the reducing 'real' purchasing power of €100,000 life cover over 20 years, assuming inflation of 2% pa throughout.

In year	Real value of cover
1	€100,000
5	€92,384
10	€83,675
15	€75,787
20	€68,643

Of course, if inflation turned out to be higher than the 2% assumed above, the real purchasing power of the cover would fall faster than shown above, and if lower than the 2% assumed above, the real value would fall at a lower rate.

- If a Temporary Assurance policy does not carry a conversion option, **the consumer may not be able to get replacement cover when their current policy ends if their health has deteriorated in the meantime**.

- While a Convertible Term Assurance policy allows a consumer to extend their cover before their current cover expires, regardless of the state of their health at that stage, **the cost of that replacement cover is not guaranteed in advance.**

  The cost of Temporary Assurance cover rises with age, so that if a consumer wishes to extend their cover before the end of their current policy term they will face a significant increase in premium for the **same** cover as before, which they might not be able to afford.

  Take for example, someone aged 35 next birthday, a non-smoker, who takes out a Convertible Term Assurance policy now for €500,000 life cover for 10 years and converts the cover after 10 years into a second Term Assurance policy (with no conversion option) for a further 10 year term:

Term Assurance policy	Monthly premium
First policy for 10 years, from 35 to 45	€37.39
Second policy for next 10 years, from 45 to 55	€72.28

- **Individual Mortgage Protection cover might be insufficient to pay off in full the mortgage outstanding on death** if the actual mortgage interest rate charged turns out to be higher than the rate assumed to calculate the Mortgage Protection premium.

  Also, the mortgage amount outstanding may have increased due to accumulation of arrears, which may not be covered by an individual Mortgage Protection policy.

2.3 Whole of Life Cover

We have seen above that Temporary Assurances are policies which provide life assurance cover for a fixed period of time, i.e., the term of the policy. At the end of this period, the life assurance cover ceases without any further benefit.

Whole of Life assurances, on the other hand, differ from Temporary Assurances in two important ways:

- Whole of Life policies *can* (but may not necessarily guarantee to, as it depends on the type of Whole of Life policy used) provide cover throughout life.

  Cover doesn't automatically cease at the end of a fixed period of time, as it does under Temporary Assurances.

- Whole of Life assurances may carry a small encashment value, if terminated. Temporary Assurances have no encashment value at any stage.

There are two main types of Whole of Life policies:

Guaranteed

Unit linked

2.3.1 Guaranteed Whole of Life

As the name implies, a Guaranteed Whole of Life policy guarantees to pay out a fixed amount of cover on death, whenever that occurs, in return for a fixed premium. It's a **fixed price deal**.

Example

Take a consumer aged 35 who needs €100,000 Whole of Life, life assurance cover.

Currently one life company charges these fixed premiums for €100,000 guaranteed Whole of Life cover (with no encashment value) for such a consumer:

Non-smoker	Smoker
€139.40 pm, payable for life	€171.75 pm, payable for life

Premiums are fixed, i.e., can't be varied by the life company, and are payable throughout life; however, in some cases the premiums may cease at an earlier age, such as 80, although cover extends throughout life.

2.3.1.1 Encashment Value

Guaranteed Whole of Life policies do not generally provide any encashment or surrender value if the policyholder decides to terminate the policy.

However, some may provide a small encashment value on encashment after a particular period, possibly in return for paying a higher premium. If the policyholder wants to stop paying premiums at a time where there is an encashment value, the options might be:

- Take the encashment value and terminate the policy and cover.

  OR

- Leave the policy to run on with no premium at a reduced level of cover, which will be payable on later death. This is referred to as a **paid-up** policy.

2.3.1.2 Charges

Guaranteed Whole of Life policies charge a fixed premium for a fixed amount of Whole of Life cover, payable for life. The premium allows for:

- The life company's anticipated cost of claims.
- The life company's administration costs of establishing and maintaining the policy, including the intermediary/sales remuneration payable in relation to the policy.
- The life company's anticipated investment return it will earn on its reserves.
- A profit margin for the life company.
- The 1% insurance premium levy payable to the Government.

Guaranteed Whole of Life policies do not usually therefore have any explicit or visible charges; all charges are bundled into the premium payable, which pays for the cover and charges.

2.3.1.3 Benefits

- **Cover is guaranteed to continue throughout life** and will pay out on death, whenever that occurs, **if** all premiums continue to be paid.
- **The premium is fixed and cannot be increased** for the same level of cover.
- **Some policies may provide a small encashment value** or the option of a paid-up reduced Whole of Life cover, on termination of payment of premiums.

2.3.1.4 Risks

- **If the cover is not increased regularly, its real purchasing power will reduce over time due to the effects of inflation**.
- **In retirement, the consumer might not be able to afford to continue paying the premium** and hence may end up lapsing the cover just when it is needed most, and a payout event is more likely.

2.3.2 Unit Linked Whole of Life

A different type of Whole of Life policy is a **unit linked** policy.

2.3.2.1 Unit Linked Policies

A unit linked life assurance policy is a policy whose encashment value is **linked** to the value of **units** in a life company's **unit fund**, which is an investment fund operated by the life company.

The unit price goes up and down in line with the value of the fund's investments.

Premiums paid to a unit linked policy are used to buy units in a unit fund at the unit price ruling on the day the premium is received by the life company:

Month	Premium paid	Unit price (assumed)	Units secured by the policy
May	€50	€1.00	50/1 = 50.00
June	€50	€1.03	50/1.03= 48.54
July	€50	€1.01	50/1.01 = 49.50

The encashment value of a unit linked policy at any time is usually:

[number of units held by the policy x unit price at that time]

Example

A unit linked policy has 987 units today, and the unit price today is €1.34.

The encashment value of this policy today is usually calculated as:

[987 x €1.34] = €1,322.58.

Unit linked policies fall into one of three categories, depending on the primary purpose of the policy:

Unit linked Savings

- A regular premium is paid to the policy to build up a capital sum over time
- The policy usually provides little or no life assurance cover, other than a return of the encashment value of the policy on death

Unit linked Investment

- One lump sum (called a 'single premium') is paid to the policy (usually called a 'bond'), to secure units in one or more unit funds.
- The policy usually provides little or no life assurance cover, other than a return of the encashment value of the policy on death

Unit linked Whole Of Life

- A regular premium is paid to secure units in one or more unit funds.
- The policy provides a certain level of life assurance cover, provided a sufficient premium is paid from time to time.
- The cost of the cover is funded by regular monthly encashments of units.
- The policy may provide a small encashment value after a period of time.
- The policy does **not** guarantee to provide cover throughout life. The premium and cover are subject to regular reviews.

Unit linked investment and savings policies are covered in Chapters 8 and 9 respectively. In this Chapter, we look at **Unit Linked Whole of Life** policies.

It is important to note that a Unit Linked Whole of Life policy does **not** guarantee to provide a fixed level of cover throughout life in return for a fixed premium; this is a very important difference between Unit Linked and Guaranteed Whole of Life policies.

The premium and cover under a Unit Linked Whole of Life policy are subject to regular review, and hence could be changed in certain circumstances.

In particular, a Unit Linked Whole of Life policy will most likely require a substantial increase in premium in the future to maintain the same cover as before; if an increase in premium is sought by the life company at some stage and the policyholder refuses to increase the premium, the life company can reduce the sum assured or terminate the policy entirely, in some circumstances.

2.3.2.2 Life Cover Payable on Death

The sum payable on death under a unit linked policy at any time is the **greater** of:

- The life assurance cover on the policy at the date of death; and,
- The encashment value of the policy at that time.

Example #1

The life assurance cover provided by a unit linked policy is €75,000.

On death, the encashment value is €2,678.

Therefore, €75,000 is payable on death, i.e., the **greater** of €75,000 and €2,678.

Example #2

The life assurance cover provided by a unit linked policy is €20,000.

On death, the encashment value is €22,345.

Therefore, €22,345 is payable on death (ignoring any tax deductions, which we will cover later), i.e., the **greater** of €20,000 and €22,345.

The **sum at risk** under a Unit Linked Whole of Life policy during a month, is the amount the life company would have to pay out if the life assured died in that month, less the encashment value of the policy at the date of death:

This is the amount the life company is 'at risk' for in that month, and hence will charge for that month by way of encashing sufficient units to pay for the cost of that cover.

Example #3

Take a Unit Linked Whole of Life policy with life assurance cover of €100,000.

At the start of a particular month the policy encashment value is €2,200.

The sum at risk for that month is:

(€100,000 - €2,200) = €97,800.

In other words, if the life assured died that month the encashment value of the policy, i.e., €2,200, would be paid out together with €97,800 of life cover to make up a total pay-out of €100,000.

So, for that month, the life company need only charge for €97,800 life cover, as the €2,200 encashment value is there anyway, to be paid out on death.

2.3.2.3 The Premium

A Unit Linked Whole of Life policy may quote a regular premium at the outset **estimated** or projected to keep the cover going throughout life. However, this premium is **not** guaranteed, as it will be based on a number of assumptions, any of which could turn out in the future to be different, such as:

- The future return which will be earned by the unit fund or funds to which the policy is linked; the higher this assumed return, the lower the initial premium will be, and vice versa.
- The level of future administration and life cover charges to be met by encashment of units.
- All premiums due will be paid by the policyholder.
- The policyholder does not take any encashments from the policy.

The assumed future unit fund return has a significant impact on the premium quoted at the outset:

Example

Take a consumer aged 35, a non-smoker, who needs €200,000 Whole of Life, life assurance cover. A Unit Linked Whole of Life policy might quote the following monthly premium to provide this cover throughout life:

Unit fund growth assumed	Monthly premium	Cover estimated to be provided for	Projected encashment value after 25 years
4% pa	€215.10	64 years, i.e., to age 100	€68,802

In this example, the premium is calculated such that, assuming a 4% pa fund growth rate is achieved, the premium will be sufficient to provide cover for life – deemed for the purposes of the calculation to be to age 100.

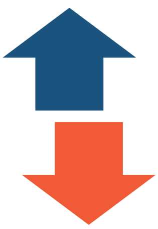
A lower investment assumption would likely give rise to a higher monthly premium, but with less chance that an increase in premium will be sought by the life company in the future.

But bear in mind, that these premiums are **not** guaranteed to provide the cover throughout life; the premium/cover is subject to regular review. See Chapter 2.3.2.7 below.

2.3.2.4 The Unit Balance

Each month some of a Unit Linked Whole of Life policy's unitholding will be encashed by the life company to pay for the cost of the life cover provided (the sum at risk) and administration charges in that month.

Therefore, a Unit Linked Whole of Life policy's unit balance is like a bank account; each month there are:



Credits*: new units bought* by premiums paid in that month.

Debits: **units encashed** each month to pay for life cover and administration expenses for that month.

Therefore, the encashment value of the policy may be increasing or decreasing from month to month, depending on the balance between new units being purchased by premiums paid and units being encashed to pay for life cover and administration expenses, and the unit price at that time.

2.3.2.5 Charges

- The premium quoted for a particular level of Unit Linked Whole of Life cover typically allows for:

- Anticipated charges to pay for the life cover.

- Administration costs of establishing and maintaining the policy including initial and ongoing intermediary/sales remuneration payable in relation to the policy.

- A profit margin for the life company.

- The 1% insurance premium levy payable to the Government.

In the previous section, we showed that these costs can be recovered by encashing units from the policy. Alternatively, some of these charges may alternatively be recovered in one or more of the following ways:

- **A non-allocation period** at the start of the policy, when the life company keeps all of the premiums paid during this period and does not use any of these premiums to buy units in the chosen unit fund or funds.

  This period may be the first 12 to 18 months of the policy, but will vary from life company to life company according to the terms of the policy.

- **Reduced allocation** of premium to buy units for an initial period: some policies use a reduced allocation of the premium to buy units over the first year or two of the policy, for example, 60% of premium is used to secure units in the first year, increasing to 100% from year two onwards. The 40% not used to buy units in the first year is a charge taken by the life company.

  An increase in premium at a later date may incur a fresh non-allocation period or reduced allocation.

- **A monthly policy fee**, which is taken from the policy before the premium is used to buy units.

- **An annual fund charge**, made to the fund or funds in which the policy holds units. For example, a typical annual fund charge might be 1% pa, and this charge is taken from the fund **before** the unit price is set, so that the unit price already reflects the deduction of this charge.

  So if a unit fund earns a return of 5% during the year but the annual fund charge is 1%, then the unit growth rate for the year will be:

  5% less 1% = 4%.

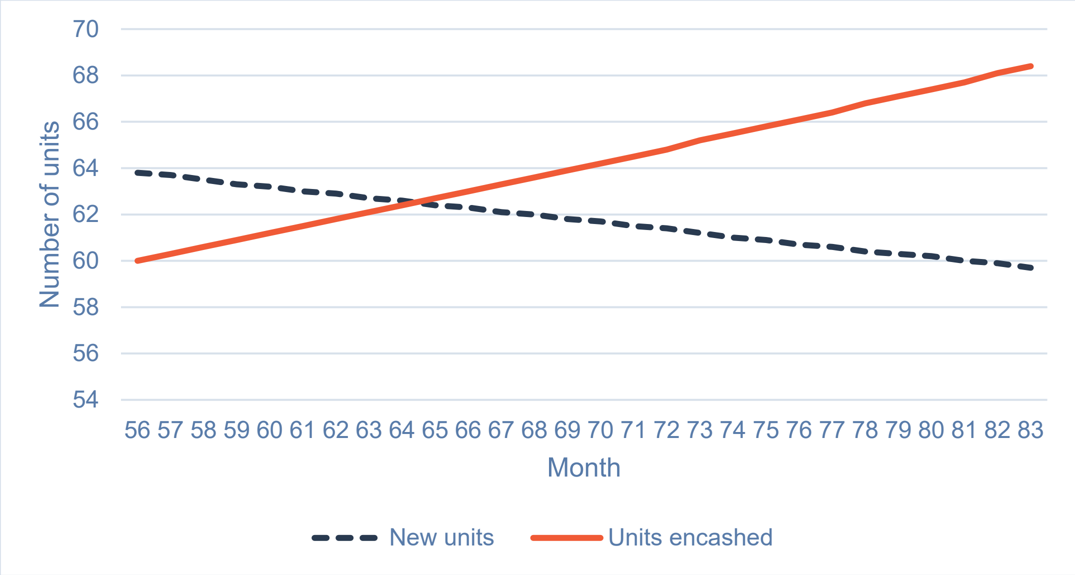
2.3.2.6 'Bomb Out'

At some stage and in most circumstances, the number of units encashed each month on a Unit Linked Whole of Life policy to pay for life cover and administration charges will consistently exceed the number of new units bought each month by new premiums paid into the policy, so that the policy's unit holding may decline on a consistent basis.

Example

Take the following assumed patterns of unit prices, and units bought and encashed in months 56 to 83 of a Unit Linked Whole of Life policy:

Month	Unit price	Premium paid	New units bought in that month	Units encashed in that month to pay for life cover and administration charges
56	€1.567	100	63.8	60.0
57	€1.571	100	63.7	60.3
58	€1.575	100	63.5	60.6
59	€1.579	100	63.3	60.9
60	€1.583	100	63.2	61.2
61	€1.586	100	63.0	61.5
62	€1.590	100	62.9	61.8
63	€1.594	100	62.7	62.1
64	€1.598	100	62.6	62.4
65	€1.602	100	62.4	62.7
66	€1.606	100	62.3	63.0
67	€1.610	100	62.1	63.3
68	€1.614	100	62.0	63.6
69	€1.618	100	61.8	63.9
70	€1.622	100	61.7	64.2
71	€1.626	100	61.5	64.5
72	€1.630	100	61.4	64.8
73	€1.634	100	61.2	65.2
74	€1.638	100	61.0	65.5
75	€1.642	100	60.9	65.8
76	€1.646	100	60.7	66.1
77	€1.650	100	60.6	66.4
78	€1.654	100	60.4	66.8
79	€1.658	100	60.3	67.1
80	€1.662	100	60.2	67.4
81	€1.667	100	60.0	67.7
82	€1.671	100	59.9	68.1
83	€1.675	100	59.7	68.4



In this example, after month 65, the number of units encashed each month to pay for the life cover/administration costs starts to consistently exceed the number of new units bought by the monthly premium. The unit holding of the policy, and hence its encashment value, starts to decline on a consistent basis and may eventually run out altogether.

As the number of units falls, the encashment value will also likely fall, and may therefore eventually fall to zero. When a Unit Linked Whole of Life policy's encashment values declines to zero, this is called '**bomb out'.**

When a Unit Linked Whole of Life policy reaches bomb out, the life company will lose money by maintaining the policy thereafter with the same level of life cover and premium as before, because there will be no units to encash to pay for the ongoing benefits and charges. The policy has become cash flow negative, i.e., the encashments from the policy to pay for benefits and charges exceed the premium being paid in and the difference has to be made up by the life company from its own resources.

If bomb out is likely to happen to a Unit Linked Whole of Life policy, the life company will offer a number of options to the policyholder:

- Increase the premium, i.e., pay more for the **same** cover.

  OR

- Reduce the cover to a level the life company estimates the existing premium can support.

  OR

- A combination of an increase in premium and reduction in cover.

If the policyholder refuses to take any of the above options, the life company will usually have the right to:

- Reduce the cover to a level it estimates the existing premium can support.

  OR

- Terminate the policy and cover in full.

2.3.2.7 Regular Premium/Cover Review

To try and avoid a situation where the encashment value of a Unit Linked Whole of Life policy might become zero, i.e. bomb out, the life company will carry out a regular **review** of the policy at specified intervals and in certain situations, such as:

> The life company will regularly review a Unit Linked Whole of Life policy; following such a review, the premium may have to be increased to maintain the same cover as before.

- First after 10 years and then every five years thereafter, but usually yearly after a certain age such as 70.
- After a partial encashment, whenever that occurs.
- If the policyholder reduces the premium or stops paying premiums altogether.

At a policy review the life company will look at:

- The level of cover then provided by the policy;
- The encashment value, if any, of the policy; and,
- The premium then being paid.

The review will determine if the premium then being paid is likely to be able to maintain the level of cover until the next review date, i.e., determine whether the encashment value of the policy is projected to become zero before the next review date.

If this seems likely, the life company will recommend an increased premium for the same cover, or a reduced level of cover (if the premium is not increased).

If the policyholder refuses to increase the premium as recommended at such a review, then the life company will usually be entitled under the policy conditions to either:

- Reduce the cover to a level that can be supported by the premium the policyholder is prepared to pay.

  OR

- Terminate the policy entirely if the policy does not have an encashment value.

2.3.2.8 Disclosure of Information Notice

Where a consumer takes out a life assurance policy, Regulations require the adviser or life company to provide the consumer with a Disclosure of Information Notice (sometimes referred to as a '**disclosure notice'**) *before* the client signs the application form for the policy (also called the **proposal form**).

In the case of a Unit Linked Whole of Life policy, the Disclosure Notice must state:

- The period for which the life cover is estimated to be maintained by the premium shown based on the investment return assumption underlying the illustration; and,
- That an increased premium will be required to sustain cover beyond the period shown.

Where the projected period of cover shown in the Disclosure Notice is less than the life assured's 100th birthday, the cover **cannot** be described as Whole of Life, and the illustration must show the increased premium estimated to provide the cover for 10 years longer than the projected period of cover for the premium in question.

Example

Joe is aged 42 taking out a Unit Linked Whole of Life policy. Joe is proposing for €200,000 cover at a premium of €185 pm. The Disclosure Notice projects that this premium will maintain the cover for a period of 31 years, i.e., until Joe is aged 73, assuming an investment return of 4% pa is achieved.

As the projected period of cover will end before Joe's 100th birthday:

- The policy **cannot** be said to provide 'Whole of Life' cover; and,
- The Disclosure Notice must show the increased premium estimated to sustain the cover for 41 years, i.e., 31 + 10 years, until Joe's 83rd birthday.

2.3.2.9 Stopping Premiums

Unit Linked Whole of Life policies do **not** automatically lapse on non-payment of premiums if the policy at that time has an encashment value.

Where the policyholder stops paying premiums at a time when the policy has an encashment value, the options will usually include:

- Take the encashment value. The policy and cover are then cancelled immediately.

  OR

- Maintain the policy and cover for a temporary period; each month the cost of the life cover and charges is taken from the encashment value, for as long as there is any residual encashment value left. The encashment value is run down and when it reaches zero, the policy and cover are then cancelled immediately without any further benefit.

2.3.2.10 Benefits of Unit Linked Whole of Life Cover

- **Potentially cheaper Whole of Life cover than Guaranteed Whole of Life cover**; however, Unit Linked Whole of Life cover does not guarantee to provide the initial level of cover throughout life at the initial premium, which Guaranteed Whole of Life cover does.

- **Possible small encashment value if policy is terminated**. Alternatively, this encashment value may sustain the cover for a further limited period if premiums are terminated.

2.3.2.11 Risks of Unit Linked Whole of Life Cover

- **Unit Linked Whole of Life cover does not guarantee to provide the initial level of cover throughout life at the initial premium level**.

- **The premium may have to be increased substantially later for the same cover, or the cover reduced or cancelled entirely** by the life company if the premium is not increased. The premium and continuation of cover is therefore subject to a number of risks, including investment risk, i.e. the risk that the unit fund or funds fail to produce the rate of return assumed to calculate the initial premium.

2.3.3 Joint Life Cover

Guaranteed and Unit Linked Whole of Life policies can usually be arranged to cover one or two lives assured:

Single life	Joint life first death	Joint life last survivor
Pays out on the death of the single life assured.	Pays out on the death of the ***first*** of two lives assured to die.	Pays out on the death of the ***last*** of two lives assured to die.

Joint life last survivor cover does **not** pay out on the first death. Instead on the first to die, the survivor can continue the policy and premium payments, and the policy pays out on the later death of this survivor assuming all premiums continue to be paid. This type of cover is often used to provide for Inheritance Tax which is expected to arise on the death of the last of a married couple/civil partners to die. (See Chapter 4.2.8 for more on Inheritance Tax.)

Joint life last survivor cover is cheaper than joint life first death cover, because it will be much longer before it pays out, i.e., both lives assured will have to die before it pays out, but under a joint life first death policy it will pay out on the first of the two lives assured to die.

Therefore, joint life first death and joint life last survivor policies both only pay out **ONE** sum assured; on joint life first death the cover is paid out on the first of the two lives assured to die, but under a joint life last survivor the cover is paid out on the last of the two lives assured to die.

2.4 Ancillary/Optional Benefits

Life assurance policies, Temporary or Whole of Life, may provide other benefits (in addition to life cover) either built into the cost, or in return for an additional premium. In some cases, there may be an upper age limit to the availability of these ancillary/optional benefits or to the payment of the benefit.

Automatic increase/indexation of cover

- The cover is **automatically** increased each year even if the life assured is then in bad health.
- The premium will also increase, sometimes at the same rate as the increase in cover, but usually at a faster rate because the cost of life cover increases with age.
- An indexation option provides the policyholder a way to maintain the 'real' value of cover in the face of inflation.

Insurability option

- An option to increase the cover even if the life assured is then in bad health, should certain events happen which are likely to give rise to a need for more cover, e.g:
  - Birth or adoption of a child.
  - Marriage.
  - Increasing a mortgage when moving house.
  - The premium also increases, if the option is taken up.

Example: Insurability Option

Vytautas has a 15-year Term Assurance policy on his life for €100,000 life cover. The policy contains an insurability option which allows John to increase the cover by up to €30,000 on the birth of a child, regardless of the state of his health at that stage.

Vytautas's wife gives birth to a child and Vytautas exercises his right to increase the cover to €130,000, without having to prove he's in good health at that time.

The premium will be increased to reflect his age and remaining term, at that stage, but must be based on the life company's 'normal' rates at that time.

Insurability options are usually subject to restrictions such as:

- When the cover may be increased; there may be a maximum period, for example, three months, after the happening of a specified event, by which the insurability option must be exercised;
- The maximum age at which the options may be exercised, for example, age 55;
- The total maximum amount by which the cover may be increased, under such options, for example, the lower of €200,000 and the original level of cover;
- The maximum number of times the option may be exercised; and
- The new cover will not carry any further insurability options.

Other ancillary and optional benefits on Temporary Assurances or Whole of Life policies include:

Serious Illness cover

- Serious Illness cover pays out a lump sum if the life assured is diagnosed as developing one of a range of serious illnesses covered by the policy.
- A policy can provide life assurance cover only, Serious Illness cover only, or both life assurance and Serious Illness cover.
- See Chapter 3 following on Serious Illness cover for more details.

Terminal Illness cover

- The life assurance cover is payable immediately on the diagnosis of a terminal illness with less than 12 months to live.
- When paid out, the life assurance cover is then cancelled.

Children's life assurance cover

- Life assurance cover for children of the life assured; for example, children of the life assured may be covered for a small sum, such as € 5,000 up to their 21st birthday if in full time education (or else up to age 18).

Hospital Cash

- Pays out a daily amount, typically between € 75 and € 250 per day, if the life assured is hospitalised for more than a certain minimum number of consecutive days, for example, more than three days.
- Typically there is a limit on the maximum total number of days that can be claimed under the policy, for example, 365 days, and the cover may end at age 60, even if this is still within the term of the policy.

Accident Cash

- Pays out a weekly amount, in the event that the life assured is unable to work for more than a specified period, for example, two weeks, because of physical injury arising from an accident.
- The cover is usually limited to a percentage of the life assured's earnings, for example, 40% of gross earnings.
- Typically the weekly payment ceases on the earlier of return to work or one year.

Waiver of Premium (WOP)

- Pays the premium for the policyholder if the life assured is unable to work due to sickness or disability lasting longer than a specified period, for example, 13 or 26 weeks.
- Cover usually ceases at an upper age, for example, 60th or 65th birthday.

Accidental Death Cover

- Pays out a fixed lump sum amount if the life assured dies directly and solely as a result of bodily injury arising from an accident, for example, life assured dies from injuries received in a car accident. This payment is in addition to the basic cover on the policy.
- Payment of benefit will usually be subject to many exclusions, for example, death caused by drink driving may result in no claim payout, etc.
- Cover will cease at a predetermined age, for example, 65.

2.5 Benefits

Life assurance cover provides a lump sum payment on death which can be used to:

- **Fund a replacement income for dependants**, who depend on the life assured's earned income for their standard of living.
- **Pay off a mortgage and other loans**, which are funded by earned income of the life assured.
- **Pay off taxes arising on death**, such as Inheritance Tax.
- **Fund an inheritance for next of kin.**

Life assurance cover is inherited tax free by the deceased's spouse/civil partner. For other beneficiaries, the inheritance of the funds is a taxable inheritance for Inheritance Tax purposes. See Chapter 4.2.8.1 for more on Inheritance Tax.

2.6 Restrictions

Life assurance cover is usually subject to some restrictions.

The life assured must be in good health when taking out the policy

To take out the cover, the life assured will have to complete an application form answering questions about their health, occupation, etc., and, in some cases, provide evidence of the state of their good health, for example, by attending a medical examination.

Some consumers may not be able to get life cover at all or may only be able to get it at an increased cost, if they are in bad health or have some medical condition which may significantly reduce their expectation of life at the time they seek cover.

From 6th December 2023, insurers will disregard a medical history of cancer in specific circumstances in relation to applications for mortgage protection. See Chapter 11.3.4 for more information.

Exclusions on benefit payout

An exclusion is a provision in a policy which defines the circumstances in which the insured benefit will **not** be payable, should the insured event occur.

A suicide exclusion clause is typical in most life assurance policies, including Temporary Assurances:

Example #1

Most life assurance policies provide that no death benefit is payable in the event of suicide of the life assured during the first year of the policy (some companies may alternatively specify the first two years).

This exclusion is designed to prevent individuals who are contemplating suicide effecting a life assurance policy and then committing suicide shortly afterwards and, in the process, financially benefit their dependants or next of kin.

Some suicide exclusion clauses may be qualified as not applying where the policy has already been assigned to a third party not related to the policyholder, for example, to a mortgage lender as security for a mortgage.

Pre-contractual duty of disclosure of a consumer

The consumer is under a duty to answer all questions posed by the insurer honestly and with reasonable care (the test of reasonable care being by reference to that of the average consumer).

An insurer may repudiate liability or limit the amount paid on foot of the contract of insurance if it establishes that non-disclosure of relevant information was an effective cause of the insurer entering into the relevant contract of insurance and on the terms on which it did.

Example #2

Joe when proposing for a Term Assurance policy with ABC Life Co ticked 'No' in answer to a question on the proposal form asking him if he had undergone any medical investigation within the previous five years.

However, in fact Joe had undergone an MRI scan just six months earlier; he decided to not tell the life company about this.

As he has consciously withheld important relevant information known to him when taking out the policy, the life company could refuse to pay out a later death claim on this policy if the claim arose from something that had come up in the scan.

Change in Occupation or Country of Residence

Some ancillary or optional benefits may not be payable in the event that the life assured changes their occupation or moves to live in another country, after taking out the policy.

Review

Now consider the main teaching points, which were introduced in this Chapter. They are listed below. Tick each one as you go through them.

- Temporary Assurances ☐
- Whole of Life cover ☐
- Ancillary options and benefits ☐
- Benefits and Restrictions ☐

Sample Questions

The answers to these questions can be found in your Study Hub.

1. John and Maria have a dual life Term Assurance policy covering John for €100,000 and Maria for €125,000 life assurance cover. If they both die together in a car crash, what TOTAL amount will be paid out on the policy?

   A. €25,000
   B. €100,000
   C. €125,000
   D. €225,000

2. The term 'days of grace' in relation to a Term Assurance policy means?

   A. A period of time at the commencement of the policy during which no premium is charged.
   B. The maximum period of time during which a life company must pay out a death claim, following receipt of notification of the death of the life assured.
   C. A period of time after a premium due date, during which the cover continues even if the premium was not paid when due.
   D. The period of time for which a quotation issued by the life company is valid.

3. Which of the following is a risk for a policyholder with a unit linked whole of life policy?

   (i) The initial premium might not sustain the initial cover for the period illustrated at the outset.
   (ii) The policyholder may have to pay an increased premium for the same cover.
   (iii) The cover might be reduced by the life company at a policy review.

   A. (iii) only.
   B. (i) and (ii) only.
   C. (ii) and (iii) only.
   D. (i), (ii) and (iii).

4. The ongoing cost of cover and administration charges for a unit linked whole of life policy is paid by:

   A. a monthly encashment of units allocated to the policy.
   B. an appropriate increase in the monthly premium.
   C. an appropriate reduction in the sum assured, from month to month.
   D. a monthly direct debit from the policyholder's bank account.

03

Serious Illness Cover

Chapter 3 looks at different types of Serious Illness cover available to mitigate the financial impact of serious illness and/or an inability to work due to sickness or accident, including Serious Illness cover and Income Protection. The Chapter also covers the suitability of each type of cover, taxation aspects and the benefits, limitations, restrictions and risks which may apply to that cover.

Learning Outcomes – after studying this chapter you should be able to:
explain the different types of Serious Illness cover including: - lump sum cover, either on a standalone or accelerated basis; - Permanent Total Disability and Loss of Independent Existence cover; - Income Protection (IP) cover; - Personal accident and accident disability insurance; and - the benefits, limitations, restrictions, charges and risks associated with each type of cover.

Chapter weightings	Number of questions which may appear		
In the exam, questions are taken from each Chapter based on the following approximate chart:	Chapter	Minimum	Maximum
	3	6	8

Serious Illness cover provides, as the name suggests, a pay-out in the event of the life assured developing a Serious Illness covered by the policy.

There are two types of Serious Illness cover:

Lump sum cover

- Pays out a lump sum if the life assured becomes diagnosed as having developed one of a number of serious illnesses specified in the policy conditions.

Income Protection cover

- Pays out a regular income if the life assured becomes unable to work due to sickness or disability lasting longer than a specified *deferred period*, for example, 13 or 26 weeks, i.e., payment of the income protection benefit is deferred for a period so that it only pays out for longer term absence from work due to illness or disability.

We now look at each of these different types of Serious Illness cover.

3.1 Lump Sum Cover

Life assurance policies may offer Serious Illness cover either in conjunction with life assurance cover (called **accelerated** serious illness cover), or with either a nominal level of life assurance cover or no life cover at all (called **stand-alone** serious illness cover).

Serious Illness cover pays out a capital sum should the life assured be **diagnosed** as developing one of the serious illnesses specified by the policy. Medical proof of such diagnosis is required for payment.

A life assured must be diagnosed as suffering from a Serious Illness covered by the policy before Serious Illness cover can become payable.

Serious Illness cover provides financial support at a time when life may be endangered and can ease the financial stress caused by serious illness.

The serious illnesses specified by the policy will vary from life company to life company. Typically, the illnesses covered include most forms of cancer, heart attacks of a specified gravity, stroke, certain coronary artery surgery as well as specific illnesses such as Alzheimer's, etc.

Each of the illnesses or conditions covered are defined in detail in the life company's policy conditions. For example, heart attack may require a confirmed change in the life assured's ECG pattern and evidence of raised enzymes, while stroke cover may require a diagnosed permanent neurological deficit.

Some illnesses may also be subject to specific **exclusions**. For example, while most Serious Illness cover will include *cancer* as a covered illness, most will exclude non-invasive and pre-malignant cancers.

Most serious illness policies distinguish between:

- Certain serious illnesses, where the *full* serious illness sum assured is payable; and

- Less serious illnesses, where only *part* of the sum assured is payable, known as *partial payments*.

In some cases, this partial payment is separate from the other Serious Illness cover and hence payment of a benefit caused by a less Serious Illness covered by the policy does not reduce the level of cover provided for the other more serious illnesses.

Some illnesses may require the life assured to be diagnosed as suffering from the illness for a specified minimum period before the Serious Illness cover pays out.

An example might be Multiple Sclerosis, which may require the insured to be diagnosed specified symptoms of the disease for at least the previous six months, before the Serious Illness cover can become payable. Such time periods are specified to ensure that the life assured is *permanently* suffering from the illness in question.

Lump sum Serious Illness cover is usually available in one of two formats:

Accelerated	Standalone
• An accelerated or advance payment of part or all of the life assurance cover also provided.	• With no attaching or a nominal level of life assurance cover.

3.1.1 Accelerated Payment of Life Cover

Accelerated Serious Illness cover may be available as an optional or *rider* benefit on some Term Assurance and Whole of Life policies providing life assurance cover.

If accelerated Serious Illness cover is added to a policy, the sum assured is payable on the **first** to happen:

- Death of the life assured, causing the payment of the life assurance cover;

  OR

- The life assured becomes diagnosed as developing one of the serious illnesses covered by the policy, before a certain age, such as 70 or 75; in this case the payment of the life assurance cover is *accelerated* or paid out earlier as the serious illness cover.

Example #1

Mr Smith takes out a policy with ACME Life Co. for €100,000 life assurance cover with full accelerated Serious Illness cover.

Some years later Mr Smith suffers a serious heart attack and claims the €100,000 Serious Illness cover.

The claim is accepted by the life company and the €100,000 is paid out to Mr Smith as an acceleration or advanced payment of the life cover. The policy is then cancelled with no further benefit as the cover can only be paid once, as a serious illness claim or as a death claim.

Therefore, accelerated lump sum Serious Illness cover is paid ONCE only, either on death or in the earlier event of a diagnosis of the life assured developing a serious illness covered by the policy.

Example #2

Take a consumer aged 35, a non-smoker, who needs €250,000 life assurance and Serious Illness cover for 25 years.

Currently one life company charges these premiums for €250,000 Term Assurance life cover only, and €250,000 term life cover plus accelerated Serious Illness cover:

Term	Life cover only	Life cover and accelerated Serious Illness cover
25 years	€20.91 pm	€94.44 pm

Some policies allow the level of accelerated Serious Illness cover to be less than the life cover, sometimes referred to as **partial accelerated Serious Illness** cover.

Example #3

Mr. Smith takes out a policy with ACME Life Company for €250,000 life cover and €100,000 accelerated Serious Illness cover.

Some years later Mr Smith suffers a heart attack and successfully claims the €100,000 Serious Illness cover.

The €100,000 Serious Illness cover is paid out to Mr Smith.

His life cover is then reduced by this amount to €150,000 and Mr Smith can continue the policy with the €150,000 life cover, subject to continued payment of premiums.

Accelerated Serious Illness cover can be added to Mortgage Protection policies, where, for an additional premium outlay, the mortgage can be cleared in full should the borrower be diagnosed as suffering from a Serious Illness covered by the policy, such as cancer.

Example #4

Take a couple aged 35 (both non-smokers) who borrow €250,000 from a bank over 25 years on a capital and interest mortgage. These are the premiums currently charged by one life company, assuming a mortgage interest rate of 6%:

Life cover only	Life cover plus accelerated Serious Illness cover
€25.63 pm	€113.54 pm

3.1.2 Standalone Serious Illness Cover

Individuals who already have adequate life assurance cover may need just Serious Illness cover on its own, without any additional life cover.

Life companies also offer **standalone** (also called **independent)** lump sum Serious Illness cover with little or no benefit payable on death. Such cover is designed for those who have a Serious Illness cover need, but not an equivalent life assurance need.

Typically, policies providing standalone serious illness cover may also provide a small death benefit, such as 5% of the serious illness sum assured or maybe a year's premium, if the life assured dies *before* making a serious illness claim.

Payment of standalone Serious Illness cover on the diagnosis of a Serious Illness covered by the policy is also usually subject to an additional requirement, i.e., that the life assured survives a minimum period from the date of diagnosis of the serious illness in question. This period is typically 10 or 14 days but can be longer for some illnesses.

Example #1

Mary effects a €100,000 standalone Serious Illness policy with ACME Life Company. The policy has a survival requirement of 10 days for payment of the benefit.

Some years later she was diagnosed as suffering from a serious form of cancer, which was covered by the policy.

As she survived for at least 10 days from the date of diagnosis of the cancer the serious illness sum assured of €100,000 is payable.

Once the serious illness claim is paid the policy is cancelled.

Consider another example where the life assured dies within a very short period after serious illness is diagnosed.

Example #2

Joe effects a €100,000 standalone Serious Illness policy with ACME Life Company. The policy has a survival requirement of 14 days after diagnosis for payment of the benefit. The death benefit is 5% of the serious illness sum assured.

Some years later he suffers a stroke but dies five days after diagnosis of the stroke.

As he did not survive for at least 14 days from the date of diagnosis, the serious illness sum assured of €100,000 is NOT payable.

However, a death benefit of €5,000 in this example is paid.

The reason for the minimum survival period requirement for standalone Serious Illness cover, is that such cover is not designed to provide life assurance cover for dependants, but rather to provide benefits for the policyholder in the event of them surviving a serious illness.

3.1.3 Double Cover

Double cover is a name given to a policy which provides life assurance cover AND standalone Serious Illness cover within the one policy. Both covers can potentially be paid out ... hence the term **double** cover.

Example

Mr White effects a policy with ACME Life Company for €200,000 standalone Serious Illness cover AND €150,000 life cover. The policy has a survival requirement of 14 days for payment of the standalone Serious Illness cover.

Some years later he suffers a stroke but recovers from it. The policy's Serious Illness cover includes stroke as one of the illnesses covered.

As he survived for at least 14 days from the date of diagnosis, the standalone serious illness sum assured of €200,000 is paid out on a confirmed diagnosis of the stroke.

His life cover of €150,000 is not affected by the standalone Serious Illness claim. He continues the policy with the €150,000 life assurance cover, subject to continued payment of premiums.

Some years later Mr White dies. €150,000 is paid out as the death benefit. In total €350,000 was paid out under the policy, i.e., the standalone Serious Illness cover plus the separate life assurance cover.

The important point to note about double cover is that the payment of the Serious Illness cover does not reduce the life cover, as it would under accelerated Serious Illness cover.

3.1.4 Cessation of Serious Illness Cover

Most insurers impose an upper age limit at which lump sum Serious Illness cover ceases, for example, 75th birthday, even if the life cover continues after that age.

3.1.5 Permanent Total Disability Cover

Permanent Total Disability (PTD) cover pays out the sum assured on the diagnosis of the life assured becoming *permanently* unable to work again due to sickness or disability. It is important to note that **permanent** disability is required for pay-out, not just a temporary inability to work.

Sometimes PTD is one of the list of serious illnesses covered by Serious Illness cover; in other cases, it may be an optional benefit which can be added to life cover, as an acceleration of the life cover.

There are two types of PTD cover:

Any occupation	Own occupation
• The PTD benefit is only paid if the life assured is permanently unable to follow *any* occupation.	• The PTD benefit is paid if the life assured is permanently unable to follow his or her own occupation or any similar occupation.

PTD cover may not be offered to consumers involved in certain occupations, or may be offered at an increased premium where, for example, the consumer is deemed to have a higher level of risk of having an accident at work, for example, a farmer or construction worker.

In some cases, the life company may be willing to offer certain occupations **any occupation** PTD cover but not **own occupation** cover.

PTD cover normally ceases at age 65, as the normal PTD pay-out requirement is being unable to follow an occupation, either own or any. Therefore, as most people normally stop working around 65, PTD cover tends to stop at this age.

3.1.6 Loss of Independent Existence

Some policies offer an alternative PTD-like cover which pays out a lump sum if the life assured is diagnosed as being permanently unable to live an independent existence, as defined in the policy conditions.

Examples of conditions which might meet lead to a pay-out under this benefit include:

- Permanent confinement to a wheelchair.
- Being unable to carry out unaided at least three of a list of specified daily activities, such as washing, dressing, going to the toilet, feeding, walking, etc.

There is no requirement to be unable to undertake an occupation to qualify for the benefit.

3.1.7 Waiting Period

Payment of some illnesses may require the illness to persist for a certain minimum period, often called a **waiting period**, to verify that the illness is permanent.

3.1.8 Partial Payment of Serious Illness Cover

Most Serious Illness cover policies may provide a partial payment of the Serious Illness cover for certain illnesses covered by the policy, such as less serious cancers. The payment level may be capped at an amount such as €15,000 or €20,000.

In most instances, Serious Illness cover **is not** reduced by the partial payment amount that is paid in the event of a claim. However, some policies pay partial payments and full payments for different levels of severity of the same condition and in these instances, Serious Illness cover **is** reduced by the partial payment amount that is paid in the event of a claim for the related illness. For example:

- A Serious Illness cover claim for *Crohn's Disease – of specified severity* would be reduced by the amount of any Partial Payment Specified Illness benefit previously paid under the policy for *Crohn's Disease – treated with surgical intestinal resection*, and;
- A Serious Illness cover claim for *Peripheral Vascular Disease – treated with by-pass surgery* will be reduced by the amount of any partial payment specified serious illness benefit previously paid under the policy for *Peripheral Vascular Disease – treated with angioplasty*.

Example #1

Sean has life assurance plus accelerated Serious Illness cover of €200,000 with ABC Life.

The policy provides a payment of Serious Illness cover of €15,000 if Sean can provide proof that he requires a heart pacemaker to be fitted.

Some years later, Sean develops an abnormal heartbeat which requires the permanent insertion of an artificial pacemaker. He can claim €15,000 on the policy. His life and accelerated Serious Illness cover will be unaffected by the partial payment and he will still have €200,000 cover under the policy.

Example #2

Pawel has stand-alone Serious Illness cover of €100,000 with XYZ Life.

Pawel is diagnosed with Crohn's Disease which eventually requires surgery to remove part of his bowel. He successfully claims under his Serious Illness policy for a partial payment of €15,000.

If Pawel's condition worsens in the future, necessitating further surgery and despite ongoing treatment he is still experiencing symptoms, any successful claim for Serious Illness Cover for this condition will be for €85,000. If, however he claims for any other full payment Serious Illness, the amount payable would be €100,000.

3.1.9 Children's Serious Illness Cover

Some Serious Illness policies may add in Serious Illness cover for children of the life assured, in addition to Serious Illness cover for the life assured. For this purpose, a 'child' may be defined as someone over age one and under age 18 or 21 and is a biological or legally adopted child of the life assured.

The cover will usually pay a reduced level of the Serious Illness cover, typically 50% to a maximum of, say, €10,000, where the child is diagnosed as suffering from a Serious Illness covered by the policy. Such cover is usually subject to a pre-existing medical condition exclusion, i.e., claims arising from an illness or condition known to exist in the child at the time the policy started.

3.1.10 Benefits of Serious Illness Cover

Lump sum Serious Illness cover provides a **tax-free capital sum for the policyholder in the event of the life assured being diagnosed as developing a Serious Illness** covered by the policy. This lump sum may enable the consumer to:

- Pay off their mortgage and other debts.
- Pay for medical care.
- Pay for renovations in their home, for example, where the consumer has become immobile.
- Stay off work until completely recovered.
- Work part-time or in a less stressful job.
- Take early retirement.

3.1.11 Limitations and Restrictions of Serious Illness Cover

In general, **payment of lump sum Serious Illness cover is subject to more restrictions and exclusions than apply to life assurance cover**.

Although the precise exclusions will vary from policy to policy, a serious illness claim might typically be *excluded*, i.e., not paid, in the following circumstances:

- If the illness is caused directly or indirectly by war, riot, revolution or a similar event.
- If the illness is caused directly or indirectly by taking part in a criminal act.
- If the illness is self-inflicted or is caused directly or indirectly by the life assured engaging in alcohol or drug abuse.
- If the life assured failed to follow reasonable medical advice.
- If the illness is caused by the life assured taking part in certain hazardous pursuits, such as abseiling, parachuting, etc.
- If the life assured is residing outside certain specified geographical areas, such as the EU, Australia, Canada, New Zealand, Norway, South Africa, Switzerland and the US. Therefore, if a life assured covered by Serious Illness cover commences to live in a country outside the specified countries, the Serious Illness cover may no longer apply.
- HIV infections caught outside certain specified areas, and caught otherwise than from a blood transfusion, a physical assault, or from working in certain occupations, for example, prison officer.

Also note certain typical **restrictions** on Serious Illness cover:

- It does not cover every illness the life assured might develop; it only covers those illnesses specified in the policy conditions.
- As already pointed out, a claim is only payable in respect of a confirmed medical diagnosis of an illness as defined by the policy conditions. Each illness is defined in precise terms and sets a threshold level of proof before the serious illness claim can be paid. For example, not every heart attack or cancer will meet the precise definitions of such illnesses as set out in the policy conditions, and hence may not qualify for payment of a serious illness claim.
- Some serious illness claims require the life assured to be confirmed as suffering from the relevant illness for a specified minimum period for example, three or 12 months, before the claim is payable.
- Stand alone, or independent, Serious Illness cover is payable only where the life assured survives for a specified minimum period, for example, 14 days, from confirmation that the life assured is suffering from an illness covered by the policy.

It is therefore important when considering Serious Illness cover to always bear in mind and to make the client aware of the differing definitions of illnesses, and differing exclusions and restrictions, which may apply to the cover provided by such policies, and to encourage the client to truthfully answer all questions asked by the life company when proposing for such cover.

The Central Bank’s Consumer Protection Code requires advisers recommending serious illness policies to consumers to ‘*explain clearly to the consumer the restrictions, conditions and exclusions that attach to the policies*’ **before** the consumer completes the proposal form for such a policy.

3.1.12 Risks of Serious Illness Cover

The risks, if any, attached to lump Serious Illness cover will vary according to the nature of the protection policy, i.e., typically:

- A Temporary Assurance; or,
- A Whole of Life policy.

These would be in line with those risks already outlined in Chapter 2 in respect of life cover.

In addition, in relation to lump sum Serious Illness cover there is the risk that the insured may develop a serious illness that either:

- **Is not covered by the particular policy**; or,
- **Does not meet the specific definition of the serious illness in question**, for example, the insured gets a skin cancer which is non-invasive and hence not covered by the definition of cancer provided by the policy, which may cover cancers but not non-invasive ones; or,
- Is **subject to one of the exclusions** that applies to that illness.

3.2 Income Protection

All the policies we have looked at so far generally pay out a *lump sum* on the happening of the insured event, i.e., death or diagnosis of a Serious Illness covered by the policy.

Income Protection (IP), on the other hand, pays out a **regular income** should the individual insured suffer a loss of earned income by being unable to work due to sickness or disability lasting longer than the **deferred period** specified in the policy, i.e., becomes payable after the initial period of inability to work due to sickness or disability.

It is important to note that there must be a **loss of earned income**, for IP benefit to become payable. It is not enough just to be sick and off work. IP is designed to partially make up a loss of earned income from being unable to work for a prolonged period due to sickness or disability.

Income Protection was formerly called Permanent Health Insurance (PHI). The term *permanent* relates to the fact that, once the life company has issued the contract, it cannot cancel it, no matter how many times or for how long there are claims made under the policy, provided the policyholder continues to pay the premiums due.

3.2.1 Deferred Period

The deferred period will typically by either 4, 8, 13, 26 or 52 weeks.

For example, if the deferred period is 26 weeks, the individual must be out of work sick for at least this period before the IP income starts to become payable. The shorter the deferred period, the higher the IP premiums for the same cover, as the benefit will become payable sooner in the event of the insured being off work due to sickness or disability.

3.2.2 Payment of Benefit

The IP benefit is payable for as long as the individual is suffering from disability, as defined in the policy conditions, beyond the deferred period, which usually means being unable through sickness or disability to follow the individual's own occupation or any other occupation for which he or she is reasonably suited or trained.

Some IP policies allow claims arising from the same cause to be **linked** for the purposes of the deferred period, so that a full deferred period may not apply to each period of illness.

Example

Alexandru is off work sick due to disability for a prolonged period. He is receiving his IP benefit. The deferred period of his IP cover is 26 weeks.

He returns to work but after just five weeks he has a relapse and goes off work again, suffering from the same illness that gave rise to the first IP claim.

If the IP cover links *similar* claims, he will be able to claim his IP benefit immediately without having to wait for another 26 weeks of illness, on the basis that the second claim is really a repeat of the first claim and not another new IP claim.

IP benefit is payable until the **earlier** of:

- The life assured returns to work.
- The life assured is deemed by the life assurance company as fit to return to work even if he or she doesn't return to work; the life company is usually entitled under the policy to terminate or reduce a IP claim payment where it feels on medical grounds that the insured is fit to return to work.

  For this reason, a life company will usually seek ongoing medical evidence, including possibly asking the insured to attend for an independent medical examination, during the term of a IP claim, to establish if the insured is still unfit on medical grounds to return to work.

  However, in some cases where it is obvious that the life assured is highly unlikely to be ever fit again to return to work (for example, a severe stroke which has left the individual permanently paralysed) the life company may cease asking the life assured to undergo regular independent medical examinations as a condition of payment of the benefit.
- The benefit cessation age. IP policies usually have a fixed age at which payment of the benefit ceases in any event, usually referred to as the **benefit cessation age**. Life companies may offer a choice of cessation age, say between 55 and 70. The older the benefit cessation age, the higher the premium cost, as the benefit, if it becomes payable, could be payable for a longer period of time.
- The life assured retires or becomes unemployed and not working. In these scenarios there is no loss of earned income while sick or disabled.

3.2.3 Taxation

PAYE taxpayers can get immediate tax relief on IP premiums paid by deduction from their wages by their employer, i.e., the IP premium is deducted from salary *before* deduction of income tax, and so receive immediate tax relief on the IP premiums. IP premiums are **not** deductible for USC or PRSI.

The self-employed can claim income tax relief on IP premiums, through their annual tax returns.

In both cases the limit on IP tax relief in a year is 10% of income for that year.

An individual can claim income tax relief on IP premiums at their marginal rate of income tax, up to an annual limit of 10% of income.

Payment of the IP benefit is subject to PAYE as if the life assured is employed by the life company while in receipt of the benefit.

However, a self-employed individual can apply to Revenue to have their IP benefits paid gross to them (i.e. not under PAYE), but the individual must then return the benefits received for tax purposes as part of his or her trading or professional income. The application to Revenue for gross payment of IP benefits must be made within 6 months after the IP policy has been taken out.

3.2.4 Premium

Most IP policies provide a fixed level of cover for the term of the policy, at a fixed premium.

However, the premium on some IP policies is reviewable by the life company, say every five years, and the premium could be increased by the life company for the same cover if their IP claims experience turns out to be worse than anticipated at the outset.

3.2.5 Indexation of Cover

Some IP policies may offer the option to increase the level of IP cover at regular intervals, without requiring the life assured to prove they are still in good health, for example, the right to increase the cover by up to 20% every three years. The life assured will pay premiums for the increase based on their age and the amount of increase taken at that time.

Most policies offer annual increases in cover to allow for inflation. The premium increases, usually at a faster rate than the rate of increase in cover, to reflect the fact that the life assured is older at each increase in cover. For example, the cover might increase by 3% per annum but the premium might increase at 3.5%.

3.2.6 Increasing Claim Payment

Some IP policies offer the option (in return for a higher premium) of an annual increase in the IP income payable in the event of a claim, for example, an increase of say 3% pa.

Example

Māris takes out an IP policy for €50,000 pa, payable after a deferred period of 26 weeks. He chooses the option to increase his claim payment by 3% pa compound if a claim arises. He does not opt to increase his cover.

Six years later Māris successfully claims on his IP policy and the life company commences paying him €50,000 pa, after the deferred period. He is off work sick for some four years. After the first year, his €50,000 income is increased by 3% to €51,500, and again by 3% in years two, three and four.

3.2.7 Proportionate Benefit

This is referred to as a **proportionate** or **rehabilitation** benefit and is designed to encourage IP claimants to go back to work on a phased basis, where an immediate return to full time work might not be medically possible at that time.

In some claims, a life company may be prepared to continue paying part of the IP claim where the individual goes back to work part time or to a different job, at a much lower level of income than before the claim commenced.

3.2.8 Group IP

While individuals can effect individual IP policies with certain life companies, most people who have IP cover obtain it through a group scheme, for example:

- A large employer may arrange a group IP scheme for its employees.
- Many public-sector unions have voluntary group IP schemes for their members, designed to bridge the gap between their sick pay and ill health pension entitlement and a specified level of income, usually 75% less any social welfare benefit or ill health early retirement pension they may be entitled to.

3.2.9 IP Charges

Most IP policies provide a fixed level of cover for a fixed period of time, for example, up to a termination age, in return for a fixed premium.

The premium allows for:

- The life company's anticipated cost of claims.
- The life company's administration costs of establishing and maintaining the policy, including intermediary/sales remuneration payable in relation to the policy.
- A profit margin for the life company.

IP policies do not usually therefore have explicit or visible charges; all charges are bundled into the premium payable, which therefore covers the benefits and charges.

However, some IP policies may charge a fixed policy fee, for example, €3 pm, on top of the regular premium as an administration fee.

3.2.10 Benefits of IP Cover

IP cover partially protects the consumer from a loss of earned income arising from sickness or disability causing the insured to be unable to work for a prolonged period, by providing a replacement income that can be linked to inflation for the period it is being paid.

3.2.11 Limitations of IP Cover

> The Central Bank's Consumer Protection Code requires advisers to '*explain to the consumer the meaning of disability as defined in the policy, the benefits available under the policy, the general exclusions that apply to the policy, and the reductions applied to the benefit where there are disability payments from other sources.,* **before** the consumer completes the proposal form for a PHI policy.

IP policies usually have extensive exclusions and restrictions on the payment of benefit.

Many of these are similar to those already outlined earlier for lump sum Serious Illness cover, for example, where the illness giving rise to the claim arises from self-inflicted injury or drug or alcohol abuse. However, the most prevalent claims are for stress and back related issues, therefore any previous history in these areas will most likely result in an exclusion on the policy for that specific area.

As for Serious Illness cover, a significant cause of refusing IP claims is the deliberate non-disclosure of relevant information about the insured's health, when proposing for the cover.

3.2.12 Restrictions of IP Cover

3.2.12.1 Maximum Benefit Payable

A typical IP specific limitation relates to the **maximum** amount of IP cover which may be paid out in the event of a claim, regardless of the level of benefit insured.

While the individual insures a particular level of income under an IP policy, IP policies usually restrict the maximum benefit payable in the event of a claim to a formula such as 75% of immediate pre-disability earnings, less the single person's State Illness Benefit:

Example #1

Mr White's earnings:	€75,000 pa.
State Illness Benefit (maximum personal rate):	€12,105 pa[1].
Maximum IP benefit = 75% x €75,000 – €12,105 =	€44,145 pa.

So even if Mr White had insured himself for, say, €50,000 pa IP cover, and paid a premium appropriate to that level of cover, in the event of a claim, the maximum benefit which would be paid would be €44,145 pa, based on the State Illness Benefit level assumed.

Between the IP benefit and the State Illness benefit, the combined income payable would be 75% of €75,000.

This formula might also be applied by the life company to restrict the maximum amount of IP cover it may offer at the outset, in addition to restricting the maximum benefit which can be paid under the policy.

Restrictions on maximum IP benefits are imposed because life companies want to make sure that people who make IP claims always have a financial incentive to return to work, i.e., to ensure than an individual with the combination of the State Illness Benefit and IP benefit is not financially better off on IP benefit than if he or she were working.

Payment of the IP benefit is also reduced by any other regular income the individual is entitled to while in receipt of the IP benefit, such as employer sick pay and other IP or disability insurance regular income.

[1] *Calculated as 52.18 x maximum weekly rate of €232. 52.18 allows for an average of 365.25 days a year (an extra day every four years for leap year) and so converts to an average number of weeks in a year of 365.25/7 = 52.18.*

Example #2

Mr White's earnings:	€75,000 pa.
State Illness Benefit (personal rate):	€12,105 pa.
Maximum IP benefit = 75% x €75,000 – €12,105 =	€44,145 pa.

Mr White goes out on long-term sickness leave from his employer, who continues to pay him a reduced salary of 25%, i.e., 25% x €75,000 = €18,750 pa.

The maximum IP benefit payable would therefore be:

€44,145 – €18,750 pa = €25,395 pa.

Between the three payments, Mr White would receive 75% of his €75,000 earnings, i.e. €56,250.

3.2.12.2 Occupations

The availability and cost of IP cover is very sensitive to the nature of the insured's occupation. Most IP insurers band their IP premium rates into different broad occupational groups, with the lowest risk occupations paying the lowest premiums and the higher risk occupations paying the highest premium rates.

For example, one life company is using this table of occupational classes for underwriting IP cover:

Occupational class	IP claim risk level	Example of occupation in this class
1	Low	Accountant
2	Slight	Chiropodist
3	Moderate	Horticulturalist
4	Appreciable	Tattooist
Decline	Unacceptable	Quarry Worker

Certain types of dangerous occupations, for example, builders, window cleaners, etc., may therefore not be offered IP cover at all.

IP cover is particularly suitable to the self-employed, who are not covered by short term State Illness Benefit. While the self-employed are covered by the State Invalidity Pension this only pays out in the event of permanent cessation of working due to sickness or disability and its current level is just €237.50 per week.

3.2.13 Risks of IP Cover

There are several risks attached to IP cover:

- **Under reviewable IP policies the policyholder is exposed to the risk that the life company will increase the premium at a future review date**, for the same level of cover.

- **The insured may make a claim on his or her IP policy which is turned down by the life company** for one or more reasons such as:

- The life company's view is that the insured is fit for work. There can often be disputes about ability to work in relation to specific conditions such as back ache and depression.

- The insured does not suffer a loss of income, even though unable to work due to a sickness or condition covered by the policy. For example, the insured may have other sources of income, such as social welfare benefits, employer sick pay, other IP cover, which may make up all of the insured's loss of earned income during sickness.

- The life assured deliberately withheld from the life company relevant information about his or her health, occupational or pastimes, at the time the cover was taken out.

- **During payment of an IP claim, the life company may review the claim and decide to terminate the IP claim** on the basis that the life company feel (due to fresh medical or other evidence) that the insured is fit to return to work, even though he or she hasn't actually returned to work.

- **The insured may pay for a level of IP cover which they cannot subsequently fully claim**, due to the operation by the life company of the maximum IP benefit clause of the IP policy, i.e., the benefit which is payable in the event of illness may be less than the insured amount at that time.

3.3 Other Covers

3.3.1 Personal Accident Insurance

An individual can suffer serious injury or even death following an accident, causing financial loss for the client or his/her dependants.

Some of the policies already covered provide some financial protection against the impact of an accident:

- Some of the illnesses covered by Serious Illness cover provide limited cover against accidents leading to severe disablement, for example, loss of limbs and permanent total disability cover.

- IP cover provides protection where an accident might lead to an individual being unable to work for a prolonged time, for example, someone who is very seriously injured in a car accident.

However, the cover outlined above would not apply to all accidents. Personal accident insurance is offered by general insurance companies as a standalone policy and is sometimes offered by life companies as a rider or optional benefit on protection policies.

Typically, personal accident insurance provides two main benefits:

- Accidental death cover, which pays out a lump sum following death by accident.

- Accidental disability insurance cover, which pays out a regular income for a limited period, following disability arising from an accident.

3.3.2 Accident Disability Insurance

This cover will pay out a fixed regular amount or a fixed lump sum in the event of the life assured suffering serious permanent disability arising directly and solely as a result of an accident causing bodily injury, for example, life assured suffers serious injuries following a car accident.

Typically, the cover pays out in the event of an accidental bodily injury, which is the sole cause of, and within a specified period (for example, within 12 or 24 months) results in, loss of sight or loss of use of a limb or permanent total disablement of the life assured. Usually, permanent total disability requires the life assured to be unable to follow any occupation or profession.

Again, payment of benefit may be subject to many exclusions, for example, flying other than while travelling as a fare-paying passenger on a licensed aircraft.

Review

Now consider the main teaching points, which were introduced in this Chapter. They are listed below. Tick each one as you go through them.

- [ ] Serious Illness lump sum cover
- [ ] Illness Income cover
- [ ] Other covers

Sample Questions

The answers to these questions can be found in your Study Hub.

1. Fiona has a Term Assurance policy for €200,000 life assurance cover and €125,000 standalone serious illness cover. What is the MAXIMUM total amount which the life company might have to pay out on this policy in certain circumstances?

   A. €75,000
   B. €125,000
   C. €200,000
   D. €325,000

2. Which of the following is a risk for an Income Protection (IP) policyholder?

   (i) They may not be able to claim the full amount of IP cover for which they are insured and pay premiums.
   (ii) The life company could cancel their cover if they make too many claims on the policy.
   (iii) The life company could stop a claim payment in certain circumstances.

   A. (ii) only.
   B. (iii) only.
   C. (i) and (iii) only.
   D. (i), (ii) and (iii).

3. Claire is insured on a policy for €200,000 life cover with €200,000 standalone serious illness cover. If Claire makes a successful serious illness claim for the full serious illness cover what life cover, if any, will she still have after the serious illness claim is paid out?

   A. Nil.
   B. €75,000
   C. €100,000
   D. €200,000

4. Income Protection was formerly called Permanent Health Insurance. The term permanent in Relation to this product relates to the fact that:

   A. cover is provided throughout life.
   B. benefit is payable for life in the event of a successful claim.
   C. life company cannot cancel the cover if the policyholder continues to pay the premiums.
   D. life company cannot refuse to offer cover to employees in permanent employment.

04

Quantifying Protection Needs

Chapter 4 provides a comprehensive overview, with many worked examples, of the four-step process involved in quantifying the level of Life Assurance and/or Serious Illness cover a client requires in order to satisfy their protection needs.

Learning Outcomes – after studying this chapter you should be able to:
quantify the five main life assurance cover protection needs a client may have, allowing for anticipated State benefits and existing cover: - Loss of earned income. - Loss on death of a carer. - Loan repayment cover. - Inheritance Tax cover. - Inheritance provision.
explain how to quantify a Serious Illness cover protection need for a client, allowing for anticipated State benefits and existing Serious Illness cover.

Chapter weightings	Number of questions which may appear		
In the exam, questions are taken from each Chapter based on the following approximate chart:	Chapter	Minimum	Maximum
	4	4	6

4.1 Protection Needs

A protection need is a need to protect the consumer and/or their dependants from the potential financial loss arising on the death and/or serious illness of the consumer.

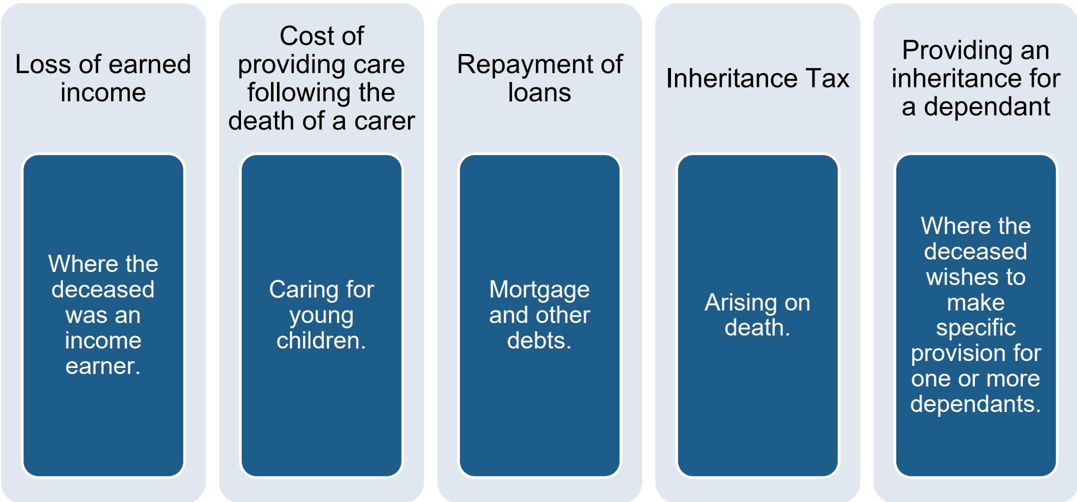
In some cases, a protection need can be met by a policy providing a *lump sum* payable on death or serious illness to cover, for example, repayment of a loan.

However, in other cases a replacement *income* is required either through cover which provides such an income (such as IP cover), or which provides a capital sum (Serious Illness Cover) which can be invested to produce a regular income over a period of time.

4.2 Quantifying Life Assurance Cover

We will first look at **quantifying** a consumer's need for life assurance cover.

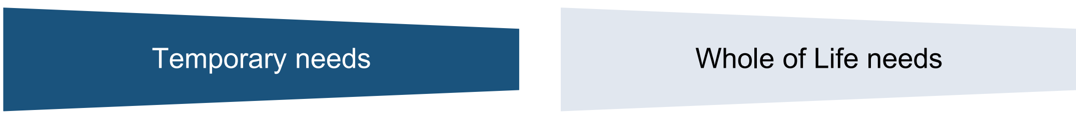
There are five main protection needs that can arise in relation to death:



The first three above are likely to be **temporary** or time limited needs, for example:

- Earned income is likely to cease or reduce substantially anyway from retirement, say from the State Pension age at the latest.
- Young children will eventually become old enough to need less caring, say when they start secondary school.
- Mortgages and other debts are likely to be serviced from earned income and so can be expected to be fully paid off by retirement age, if not earlier.

For these needs above, Term Assurances may be the best match or solution to the need, as the need is time limited.



The remaining two needs, i.e. provide for Inheritance Tax and/or an inheritance for a dependant, are likely to be **Whole of Life** needs best met, if the consumer can afford the premium, by Whole of Life cover. If the customer can't afford the Whole of Life premium, the need might be met in the short run by Term Assurances, particularly Convertible Term Assurance recognising that extending the cover later on will result in a sharp increase in the premium.

4.2.1 State Benefits

The first layer of protection against loss of earned income on death for most consumers is provided by the State.

The **State Widow's, Widower's or Surviving Civil Partner's Contributory Pension** is a valuable core protection benefit that *may* become payable to an individual after the death of their spouse or civil partner. This pension is payable to men and women who:

- Have become widowed or become a surviving civil partner[2] of a registered civil partnership;
- Have not remarried or entered into a registered civil partnership;
- Are not cohabiting with someone else; and,
- Satisfy the necessary payment of number and type of PRSI conditions. Classes A, S, B and D are the contributions that qualify for this pension.

An individual who was divorced from his or her spouse or a civil partner whose civil partnership has been dissolved, before the spouse's/civil partner's death, and has not remarried or entered into a registered civil partnership since then, can qualify for this State Pension on the death of their former spouse/civil partner, provided they meet all other requirements.

The PRSI conditions can be satisfied by either:

- The deceased's PRSI record; or,
- The surviving spouses or civil partner's PRSI record.

Entitlement to the State Widow's, Widower's Contributory Pension is **not** affected by any other income the survivor may have, for example, a spouse's pension from an employer pension scheme, but the State Pension is liable to income tax (but not USC or PRSI).

The maximum current personal rate of the pension is €237.50 pw for claimants aged under 66; a lower rate of pension is payable for those with a lower average of reckonable PRSI contributions.

The increase for each qualified child is currently €46.00 pw for children under 12 and €54.00 pw for children over 12. A qualified child is a child up to age 18, who is normally resident in the State and living with the claimant. A child aged between 18 and 22 who is normally resident in the State continues to be a qualified child if he or

> Entitlement to this State Widow's, Widower's Contributory Pension is **not** affected by any other income the survivor may have; it is not means tested.

[2] *A 'civil partner' is one of a couple of the same sex who are not married, are over age 18, not related to each other, and have registered their civil partnership under the Civil Partnership and Certain Rights and Obligations of Cohabitants Act, 2010, and the civil partnership has not been dissolved or annulled.*

she is in full-time education up to the end of the academic year in which the child reaches age 22.

The Pension is payable for as long as the individual remains a widow/widower or a surviving civil partner. The Pension stops, however, if the individual marries or remarries, enters a new registered civil partnership, or starts to cohabit with someone else.

Example

Tom and Mary are married to each other and have two young children aged 7 and 5. Both work and pay Class A PRSI. Tom dies. Mary, in addition to her own income now qualifies for a spouse's pension from Tom's pension scheme.

She can also qualify for a State Widow's (Contributory) Pension based on either:

- Her own PRSI contribution record; or,
- Tom's PRSI contribution record.

If she meets the necessary PRSI contribution conditions Mary may qualify for a pension of:

Personal rate €237.50 pw (Mary assumed to be under age 66).

Child dependants: €46.00 x 2 (both children under age 12)

Total benefit: €329.50 pw.

Mary can continue to receive this Pension whether she continues to work or not. The Pension would only cease if she remarried, entered into a registered civil partnership, or started to cohabit with someone else.

The child supplement would, of course, cease when the children cease to be a dependant, which is 18 or until age 22 if in full-time third-level education.

The Pension may be increased by the Government from year to year, but there is no guarantee.

The pension is liable to income tax but not to USC or PRSI. PAYE is not deducted at source, but if the survivor has other income, their income tax allowances and credits are adjusted to collect the income tax due on the State Pension.

The recipient of the Pension is entitled to the employee tax credit of up to €1,875 in respect of income tax arising on the State Pension if they do not otherwise qualify for the credit, for example, if their other income is not subject to PAYE.

4.2.2 The Process

The process of quantifying a life assurance protection need can be split into these four steps:

Identify annual loss of gross earned income, and period for which earned income must be replaced

Calcuate life cover required to replace the gross earned income for the specified period

Deduct existing cover not assigned, which is payable on death throughout the full specified period

Balance of cover is the additional life cover required now

The process of identifying a potential loss of gross earned income on death can be undertaken in different ways, for example:

- By use of a manual pro forma, along the lines suggested below; or,
- By use of financial planning needs analysis software which will use data from a **fact-find**,[3] and any other relevant consumer data it may have, to calculate the potential earned income loss as above.

4.2.3 Identify Loss of Gross Earned Income on Death

Where a breadwinner, i.e., an individual who is earning an income, dies their earned income is permanently lost to their dependants, if any.

However, other sources of income may then become payable to the dependants in addition to certain savings in household expenses, so that a form of **income balance sheet** can be considered for dependants, following the death of an earned income earner:

Income loss	Income gain
• Deceased's gross earned income.	• State Widow's, Widower's or Surviving Civil Partner's (Contributory) Pension? • Pension from employer pension scheme of which the deceased was a member? • Savings in future loan repayments, where loans are paid off in full on death by life assurance cover? • Savings in future living expenses in respect of deceased. (for example, food, clothes, car, etc)?
Total	**Total**

Where the income loss is likely to exceed the total income gain, there is a **protection need**, i.e., a need to protect dependants against this loss of income through the provision of a lump sum or a regular income replacement to become payable on death.

[3] *The process of collecting and assembling relevant personal and financial information about a client is generally referred to as* fact-finding*, as it involves finding or determining relevant facts about the client's financial circumstances.*

Two examples will show how the potential **income loss** might be calculated.

In the first example, we assume John's current gross earned income is €100,000 pa and his mortgage repayments are €2,000 pm (€24,000 pa) which are fully covered by a Mortgage Protection policy. We assume he is married with two children under 12.

Following John's death today, the income balance sheet might be:

Income loss		Income gain		Total gross income gain/loss
John's gross earned income:	€100,000	State Widow's Contributory Pension	+ €17,193 pa[4]	
		Savings in future gross mortgage repayments	+ €24,000 pa	
		Savings in future living expenses (say 25% of John's gross earnings)	+ €25,000 pa	
	- €100,000 pa		**+ €66,193 pa**	**€33,807 pa, gross income loss**

In the example above, the estimated gross income loss to his dependants in the event of John's death is circa €34,000 pa (rounded).

In the following case, we will assume Patrick's gross earned income is €100,000 pa, he is married with two young children and is covered at work by a widow's pension of some 4/9ths of his salary payable on his death in service. We assume mortgage repayments of €24,000 pa, fully covered by a Mortgage Protection policy.

Income loss		Income gain		Total gross income gain/loss
Patrick's earned income	- €100,000 pa	State Widow's Contributory Pension	+ €17,193 pa	
		Savings in future gross mortgage repayments	+ €24,000 pa	
		Widow's Pension from pension scheme	+ €44,444 pa	
		Savings in future living expenses (say 25% of Patrick's gross earnings)	+ €25,000 pa	
Total	**- €100,000 pa**		**+ €110,637 pa**	€0, **gross income loss**

[4] *€237.50 pw maximum Widows State Pension (assuming John's spouse Mary is then under the age of 66) plus €46.00 pw for each of two dependent children assumed to be under age 12.*

Note:

- In the Patrick example directly above, there is no loss of gross earned income, if Patrick died today. But things could change in the future; for example, he could leave his current employer's employment and pension scheme, and hence lose the benefit of his pension scheme's widow's pension of 4/9ths of his salary.

- The assumption re savings in living expenses of 25% of gross earnings is obviously a guestimate - consumers may put a higher or lower figure than this on the savings in day-to-day living expenses resulting from one less adult in the household. Some consumers may not want to allow for any such savings.

- It should not always be assumed that all loan repayments will be fully covered on death. An existing mortgage is likely to be covered, but other personal loans, car loans, etc, which may be in joint names, may not necessarily be covered by life assurance cover, or may be covered on one of the couple, and so a liability to make part or all future loan repayments may continue after death.

4.2.4 Gross or Net Income Replacement?

The earned income loss above is a loss of **gross** income. The net loss, after taxes, will usually be less but this is not always the case as the surviving spouse may be taxed more heavily as a widowed person than they were as a couple, even if receiving the same gross income as before.

For example, a married couple with one income are currently entitled to a €51,000 standard rate band, but a widowed person with dependent children gets a €46,000 standard rate band. If the couple had been in receipt of two incomes before death, their standard rate band could have been up to €84,000.

As life assurance cover will be paid tax free into a spouse's hands on death, in working out the amount of cover required to replace loss of income, it may be necessary to estimate the **net** loss of earned income from the identified gross loss of earned income, for example, one estimate might be to reduce the gross loss of earned income by 30% to give rise to a net loss of 70% of the income loss to be replaced by an equivalent amount of after tax life assurance cover.

4.2.5 Quantifying the Replacement Cover Required

Having identified a **current** annual loss of net income for dependants of, say, €2,000 pm which would arise if the client died today, there are two approaches to determining the amount of life assurance cover required to match this anticipated loss:

- Choose Term Assurance which provides a monthly payment of €2,000 pm on death, for the remainder of the term chosen.

  For example, if the identified earned income loss is, after taxes, €2,000 pm, then Term Assurance cover providing a monthly payment of this amount for the remainder of the term could be used.

  The key decision is the term chosen, which should match, as far as possible, the likely term of earned income, say up to the State Pension age of
  OR

- Use Term Assurance to provide a lump sum on death, which when invested, is estimated to provide after tax a regular payment of €2,000 pm for the full term of the policy, i.e., as if the life assured died on the first day of the policy or the worst-case scenario.

For example, if we assumed an investment return of, say, 2% pa, after taxes and charges, this table shows the capital sum required to provide a monthly payment of €2,000 pm for the full terms shown:

10-year term	15-year term	20-year term	25-year term	30-year term
€217,368	€310,937	€395,686	€472,445	€541,968

The cover above could be worked out approximately by taking 80% of the €2,000 pm payment for the full term required.

Example #1

25-year term:

Approximate cover required: = 80% x €2,000 x 12 x 25 = €480,000.

30-year term:

Approximate cover required: = 80% x €2,000 x 12 x 30 = €576,000.

Of course, in this case, the full cover is being provided for the full term of the policy, likely to be chosen to match the likely peak period of earned income, when the consumer's outgoings and responsibilities will be at their highest.

This can be argued to be too much cover as if, for example, the consumer died in the 25th year of the 25-year term policy, the full €472,445 cover would be paid even though there is a much-reduced term, if any, of earned income replacement then required.

However, there are factors to be considered:

- The consumer could die in the early years of the policy, when most or all of the full cover would be required to replace the loss of earned income;

- The difference in cost between the full life cover for the full 25 years and decreasing life cover of €2,000 pm for the remainder of a 25-year term may not be substantial and possibly affordable by the consumer:

Example #2

Take a consumer aged 35, a non-smoker. Let's assume no conversion or indexation of cover option is added in either case. These are two typical premiums quoted for insurers for the different type of cover:

A. Term Assurance life cover of €472,445: €37.30 pm

B. Term Assurance income benefit of €2,000 pm for remainder of 25-year term: €26.93 pm

If the consumer died at the start of the last year of the 25-year term under A €472,445 would be paid, but under B the pay-out would be just €24,000 paid in monthly instalments. The difference in cost is just over €10 pm, and in return the consumer gets considerably more cover later in the policy term, when he or she is older and at higher risk of dying.

- If the consumer's earned income increases substantially over time, for example, through career advancement etc., the full cover builds in some protection against the loss of this potentially higher earned income on death later on;

- Some other anticipated income sources after death used to calculate the €2,000 pm earned income loss, such as the State Widow's Pension, may not materialise or may do so for a shorter period than anticipated because of unanticipated circumstances.

Having calculated the total replacement cover required to compensate for the anticipated earned income loss, the final step is to **deduct any existing life assurance cover** the individual may have on their life which will be available to dependants on death at any time during the earned income replacement period i.e., that is not otherwise assigned as security on a mortgage.

A good rule of thumb in quantifying the total replacement life cover required is to take 80% of the total monthly net income loss for the period of cover

Example #3

Let's say we have identified a current €2,000 pm net earned income loss for 25 years. However, the client has €150,000 of existing life assurance cover on a Whole of Life policy, which would be available to dependants on death during the 25-year term.

The offset to be made against the cover required varies by the way it is proposed to protect the earned income loss, i.e., lump sum cover or income cover:

- In the case of lump sum cover, the full €150,000 existing cover is simply deducted from the estimated cover required.
- In the case of income cover, we deduct the monthly income equivalent of the existing lump sum cover of €150,000.

We could do this by dividing the €150,000 lump sum cover by 80% of the term, i.e., by 80% x 25 in this example, to arrive at an annual income and then divide this by 12 to arrive at the monthly income replaced by the existing Whole of Life cover for the full 25-year period.

Of course, this underestimates the income replaced in later years by €150,000 cover, as if the client died after 10 years, the €150,000 cover would replace a higher level of income for the remaining 15 years than if the client died at the very start of the policy. However, we will ignore this by taking planning for the worst-case scenario, i.e., that the consumer dies at the very start of the policy.

	Equivalent lump sum cover	Income cover
Cover required	Say: 80% x €2,000 x 12 x 25 = €480,000	€2,000 pm for 25 years
Deduct existing cover	- €150,000	Convert €150,000 lump sum cover to monthly equivalent for 25 years: €150,000/(80% x 25)/12 = €625 pm
Additional cover required	€330,000	€1,375 pm for 25 years

The final answer should not be taken as being precisely accurate and rounding up to the next round figure is usually acceptable, for example, rounding the €330,000 additional cover required up to €350,000 in the above example.

It is important that the adviser uses some systematic and logical system to:

1. Identify annual loss of earned income, and period for which income must be replaced
2. Calcuate life cover required to replace the earned income for the full period
3. Deduct existing cover not assigned, payable on death throughout the full period
4. Balance is the additional life cover required

By using a systematic approach like this, the recommended level of cover will be related to the consumer's financial needs and suitable for the consumer.

4.2.6 Death of Non-Income Earning Spouse/Partner

In the case of a couple, both spouses/partners may not be working. One may stay at home to mind young children, a disabled person or an elderly relative.

The death of this carer might require the survivor to recruit a paid carer, particularly in caring for pre-school and national school level children or elderly relative.

However, in trying to estimate this potential financial burden for the survivor, it should be borne in mind that:

- A surviving spouse or civil partner may be able to claim the State Widow's, Widower's or Surviving Civil Partner's Contributory Pension, based on their own PRSI record even if the deceased carer spouse/partner had never paid PRSI.

  For a surviving spouse or civil partner, qualifying for this Pension at the full rate would currently mean additional income of at least €237.50 pw, i.e., €12,392 pa, for as long as they do not remarry or cohabit with someone else.

  Of course this Pension is not payable to a surviving cohabitant who is not married or a civil partner to the deceased at the date of death.

- Both may be covered by a Mortgage Protection policy covering their outstanding home loan. It is common now to cover both on such a policy, even if only one is an income earner currently. Therefore, on the death of the carer spouse/partner, the survivor may benefit financially from the savings in future mortgage repayments.

- There may be some savings in day-to-day living expenses, with one less adult in the household.

- There may be some loss of tax credits and benefits, arising from the death of the carer spouse or civil partner. For example, the standard rate band of €51,000 applying to a married couple with one income reduces to €46,000 for a widowed person with dependent children.

- Even if paid child minders are required, they may only be required on a short-term basis until the children reach, say, age 13 or so and start in secondary school.

In the case of a couple who are spouses or civil partners to each other, the anticipated State Widow's, Widower's or Surviving Civil Partner's Contributory Pension and possible savings in mortgage repayments arising on the death of the carer, may more than financially compensate the survivor for the anticipated extra outgoings arising, i.e., cost of paid child minders, home help, and possible increased income tax liability.

Where the carer is not covered by Mortgage Protection cover in respect of a mortgage on the shared home, some minimum level of life cover recommendation is usually reasonable advice, for example, say €100,000.

In the case of a couple who are not spouses or civil partners to each other, a higher level of cover is required on the carer, as the survivor will not be eligible for the State Widow's/Widower's/Surviving Civil Partner's Pension following the death of the carer.

4.2.7 Repayment of Loans on Death

Any loans not already covered by life assurance should ideally be covered for the anticipated remaining term of the loan, so that dependants are not left with the responsibility for loan repayments, from a reduced income. The principal income earner should at least be covered, but ideally both spouses/partners.

A housing loan is usually protected by Mortgage Protection cover, but this should be checked to see if this is the case.

In particular, you should check if both spouses/partners are covered by Mortgage Protection cover, particularly if both are working and both earnings contribute to mortgage repayments.

Credit Union loans are also likely to be covered by life assurance cover provided by the credit union.

The type of loans which may not be covered by life assurance could include:

- Personal bank loans.
- Credit card balances.
- Bank/finance company car loans.
- Investment property loans, for example, mortgage to buy an investment property, where the lender did not seek life assurance cover as security for the loan.

Where a loan is already covered by life assurance cover, or your recommendation will include protecting any loans that are currently unprotected, you should remember to show the loan repayments as an income *gain* on death in assessing the earned income loss on death, as the loan will be cleared off on death by the cover.

4.2.8 Provision for Taxes Payable on Death

4.2.8.1 Inheritance Tax

Capital Acquisitions Tax (CAT) is inheritance Tax that may arise on the death of an individual with substantial assets, where those assets are inherited by someone other than the individual's spouse or civil partner. There is complete exemption from Inheritance Tax on all inheritances taken by a spouse or civil partner of a deceased person.

The total amount which a son or daughter can inherit tax free from their combined parent(s) on death is currently €335,000, assuming they have not previously received a gift over €3,000 annually or an inheritance from their parents since December 1991. After an individual receives gifts and inheritances equal to the relevant threshold amount, any further gifts or inheritances attract a tax liability for the individual of 33%.

Inheritances between spouses and civil partners are exempt from Inheritance Tax, without limit. Therefore, a spouse/civil partners can inherit an unlimited value of assets and life assurance cover from their spouse/civil partner, with no Inheritance Tax liability.

Inheritance Tax may therefore be a problem for children or other relatives inheriting, and for cohabitants, i.e. a couple living together who are not married or civil partners to each other.

Example

In January 2024, John died and left an inheritance of €1 million, which included the proceeds of a life assurance policy he held on his own life, to his son, Tom, in his will.

Assuming Tom has not previously received a gift or inheritance from his parents, his Inheritance Tax liability on this inheritance from his father will be:

First €335,000 (threshold amount) at nil:	-
Balance €665,000 at 33%:	€219,450
Inheritance Tax payable by Tom:	**€219,450**

Inheritance Tax is a tax which:

- Only arises on the **death** of an individual; and,
- Is payable by the recipient of the inheritance, the beneficiary i.e., Tom above, where the beneficiary is someone other than the spouse or civil partner of the deceased.

4.2.8.2 Tax on ARF and Vested PRSA Inheritances

Where a payment is made from an Approved Retirement Fund (ARF)[5] following the death of the ARF holder to a child of the ARF holder **over** age 21, tax is levied on the benefit inherited as follows:

- The manager of the ARF is obliged to deduct **income tax** at a fixed rate of 30%, before paying out the net benefit to the child. No other income tax is due on the benefit.
- The benefit is exempt from Inheritance Tax.

Example

Mary has €1 million in her ARF and dies, leaving the full benefit to her son Tom, who is aged 28 at the date of her death.

The manager of the ARF is obliged to deduct income tax of:

30% x €1 million = €300,000,

from the inheritance, and therefore pays out €700,000 to Tom.

Tom has no further tax liability on this benefit.

In this example, 30% of Tom's ARF inheritance has been lost to tax.

A similar position applies to similar payments after death to a child over 21, from a vested PRSA.[6]

[5] *An ARF is an investment to which an individual retiring from most pension arrangements can transfer retirement funds, instead of using those funds to buy a pension. The individual must draw on their ARF in retirement to provide an income; on death, any balance in the ARF can be left to dependants less certain tax deductions.*

[6] *A vested PRSA is a Personal Retirement Savings Account from which the holder has taken a lump sum and retained the balance in the PRSA.*

For children **under** 21, there is no income tax liability on ARF/vested PRSA inheritances from parents. Instead, the payments are taxable inheritances for Inheritance Tax purposes.

4.2.8.3 Providing for Taxes Payable on Death

In each of the above examples, Whole of Life cover can be arranged by John/Mary on their own life to provide the funds to pay the anticipated tax liability arising on their death. This would ensure their beneficiaries inherit the full value of their inheritance, with all associated taxes paid for them by the life cover.

The life assurance cover is arranged under Section 72 of the Capital Acquisitions Tax Act, typically by the policyholder completing a Declaration of Trust at the time the policy is taken out, directing that the proceeds on death be used to pay Inheritance Tax which may arise on their death. Policies arranged in such a way are generally referred to as **Section 72** policies.

The proceeds of policies arranged under Section 72 are exempt from Inheritance Tax to the extent that the proceeds are used on death to pay:

- Inheritance Tax arising on the insured's death or that of their spouse/civil partner, in respect of an inheritance provided by the insured or their spouse/civil partner; and/or
- Income tax arising on a post death distribution to an adult child (> 21) from an ARF or vested PRSA owned by the insured.

Any excess of the policy proceeds not used to pay such taxes is treated as an additional inheritance from the insured and is therefore liable to Inheritance Tax.

Any type of protection policy can be used for Section 72 purposes, but the most popular type currently used is a guaranteed Whole of Life policy where premiums and cover are guaranteed for life.

Example #1

Aoife has a Section 72 policy on her own life for a sum assured of €250,000. On her death, she leaves her estate to her husband and children. The children's total Inheritance Tax liability on their share of Aoife's inheritance is €200,000, after allowing for their Threshold of €335,000.

The children use €200,000 of the Section 72 life assurance money to pay their Inheritance Tax liability.

The use of €200,000 of the Section 72 policy proceeds by the children is exempt from Inheritance Tax, as the money from the Section 72 policy is used to pay Inheritance Tax arising from an inheritance provided by Aoife.

The surplus €50,000 proceeds, if given to the children, would be a separate taxable inheritance from Aoife subject to Inheritance Tax at 33%, as the children have already used their full Threshold amount.

The proceeds of Section 72 policies are also exempt from Inheritance Tax up to the amount of any Approved Retirement Fund (ARF) tax arising from the death of the deceased policyholder.

Example #2

Joe has a Section 72 policy on his own life for a sum assured of €500,000. On his death, he leaves an Approved Retirement Fund (ARF) worth €1,000,000 to his 30 year old daughter. The ARF manager is obliged to deduct income tax at 30% or €300,000 from the ARF before paying out the balance of €700,000 to Joe's daughter. Joe's daughter is exempt from Inheritance Tax in respect of the €700,000 inheritance from Joe's ARF.

Let's assume that Inheritance Tax of €150,000 also arose on Joe's death in respect of other inheritances provided to his dependants, after allowance for Threshold amounts.

In relation to the Section 72 policy benefit of €500,000 payable on his death:

- €150,000 is used to pay the Inheritance Tax arising for beneficiaries. The use of the Section 72 policy proceeds in this payment is exempt from Inheritance Tax.
- €300,000 is exempt from Inheritance Tax in his daughter's hands, as this amount of tax has already been deducted from the ARF left by Joe to his daughter.

The balance of €50,000, if given to Joe's children, would be a separate taxable inheritance from Joe, subject to Inheritance Tax at 33%.

To quantify the amount of Inheritance Tax which would arise for dependants today, and hence the amount of Section 72 Whole of Life cover required to cover this liability on death, you need to know:

- The current value of the assets to be bequeathed on death.

- Who are the intended beneficiaries and their relationship to the person who intends to bequeath the assets to them?

  This determines which of the three thresholds may apply on the inheritance by the beneficiaries.

Group threshold	Relationship of beneficiary to disponer, i.e., person providing the inheritance	Threshold amount
A	A child (including adopted child, stepchild, and certain foster children) or minor child of a deceased child of the disponer.	€335,000
B	A brother, sister, niece, nephew, or lineal ancestor or lineal descendant of the disponer.	€32,500
C	All other relationships.	€16,250

- How much of the available relevant threshold, if any, have the intended beneficiaries already used through other gifts and inheritances received since 1991?

- When will the assets be inherited; in the case of a married couple or civil partners where children will inherit, will it be on the first death or second death that assets will transfer to the children? This determines which type of Whole of Life coved is required, single life or joint life last survivor.

Many married couples/civil partners frame their wills to leave their estate to each other on death (exempt from Inheritance Tax), provided the other is alive, and if not, then to any children surviving.

Therefore, as there is no Inheritance Tax between spouses or civil partners, an Inheritance Tax liability would not arise in these cases until the death of the **last** of the couple to die, when assets would then be inherited by their children or others, as the case may be.

Most, but not all, Section 72 policies are arranged by a married couple on a **joint life last survivor basis**, where the policy covers two lives assured and the sum assured becomes payable on the death of the last to die when the inheritance will arise.

4.2.8.4 Cohabitants

Cohabitants are a couple who are living together, and may have children with each other, but who are not married or civil partners to each other.

For Inheritance Tax purposes, cohabitants are treated as strangers (Class C threshold applies) to each other and hence are currently only entitled to inherit €16,250 from each other before Inheritance Tax applies.

Example

Jack and Emma are living together and have two young children together aged 5 and 3. They are not married to each other.

They have a joint life, life assurance policy which pays out €200,000 to the survivor, on the death of the first of them to die. The premiums are paid from a joint bank account. Both are income earners.

If Jack dies first, Emma Will receive €200,000 from the policy. However, because the premium was paid from a joint account, it will be assumed that Emma only paid for 50% of the cost of the cover and so she will be deemed to inherit 50% of the cover, i.e. €100,000, from Jack.

After allowing for the €16,250 tax free threshold, she will have an Inheritance Tax liability of:

(€100,000 less €16,250) x 33% = €27,638.

A workaround for cohabiting couples with separate incomes is to take out two separate life cover policies, as life of another. Where in the case above Emma is 100% the policy owner and pays the premium in full from her own funds and Jack is the life assured, then Emma would receive the full benefit on Jack's death Inheritance Tax free. This is because she has paid the premiums herself.

4.2.9 Providing Funds for an Inheritance

There are circumstances in which an individual may wish to leave a capital sum to one or more beneficiaries, by providing life assurance cover to become payable on their death:

- Where the individual plans on leaving other assets, for example, the family home or business/farm to one child and wants to provide a separate cash inheritance for other children.

- Where a parent wants to leave funds after their death to provide for the care of a child who because of medical or mental health circumstances needs special long-term care.

- Where an individual wants to leave funds after their death to provide for their surviving spouse or civil partner, separate from a need to replace lost earned income or repay debts.

Where the intended beneficiary is someone other than the individual's spouse or civil partner, it is necessary to determine whether the level of intended funds is before or after Inheritance Tax.

4.3 Quantifying Serious Illness Cover

If a client is off work sick for a prolonged period and unable to earn an income, they may be able to rely, for a period, on:

State Illness Benefit

- Short-term illness.

State Invalidity Pension

- Permanent inability to work again.

Employer sick pay

- Short or long-term illness.

Employer ill health pension

- Permanent inability to work again.

4.3.1 State Benefits

- The **State Illness Benefit** is payable to those who have paid the required number and type of PRSI contributions when they become unable to work due to illness. No payment is made for the first 6 days of illness which are known as *waiting days*; Sunday is not counted as a *waiting day*.

  The current maximum personal rate of benefit is €232 pw, with an additional €154.00 pw for an adult dependant, and €46.00 pw for each dependent child under 12 or €54.00 pw if the child is over age 12. The State Illness Benefit is payable for a maximum period of two years, after which it ceases.

  The State Illness Benefit is **not** payable to:

  - Public servants who first entered the public service before 6th April 1995 who are assessed under Class D for PRSI; or,

  - The self-employed who pay Class S PRSI.

- The **State Invalidity Pension,** payable to those who have paid the required number and type of PRSI contributions when they become **permanently** unable to work again due to sickness or disability.

  The current maximum personal rate of Invalidity Pension is €237.50 pw, with an additional €169.70 pw for an adult dependant, and €46.00 pw for each dependent child under 12 or €54.00 pw if the child is over age 12.

  The State Invalidity Pension is **not** payable to public servants who entered the public service before 6th April 1995, but is payable to the self-employed who pay Class S PRSI.

Both the State Illness Benefit and the State Invalidity Pension are liable to income tax, but not to USC or PRSI.

4.3.2 Employer Provision

Employers may make provision for their employee's ill health in a number of ways:

- **Sick pay**, if it is payable, will usually only be paid for a short period, say a maximum of six months or so, before being reduced substantially or terminated fully.

  For example, an employer might pay full pay, inclusive of State Illness Benefit, for, say, four weeks, followed by half pay for another period, say about three to six months, after which the only benefit will be the State Illness Benefit. Both employer sick pay and State Illness Benefit are taxable income for income tax purposes.

  However, some employers may have Income Protection (IP) cover for their employees and so may be able to afford to continue paying part of the employee's salary for as long as the employer receives the corresponding IP benefit from the life assurance company.

  In effect, the employer insures their liability to provide long-term sick pay by taking out IP cover on their employees.

- **Ill health pension** where the employer provides an occupational pension scheme that provides a pension on ill health retirement, and the employee's illness is serious enough to warrant such early retirement. In such circumstances, the State Invalidity Pension may also become payable.

  However, some clients may not be entitled to any or all of the above financial benefits from their employer, during a period of prolonged ill health.

4.3.3 Cover Required

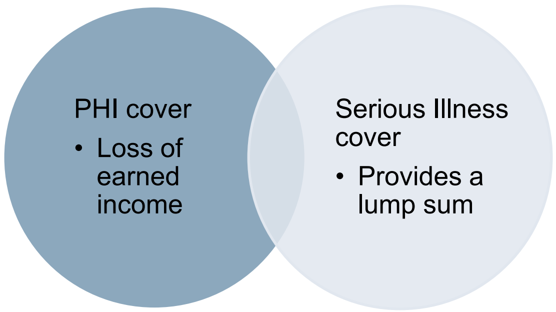
Quantifying the level of serious illness cover required to replace the loss of earned income in the event of serious illness (but not death) will depend on the type of serious illness protection product that will be used:

- **Income Protection (IP)** pays out an income**,** in the event of loss of earned income due to sickness or disability lasting longer than the deferred period covered by the policy**.**

  A precise level of potential gross earned income loss in the event of serious ill health can therefore be insured under an IP policy. Normally the maximum cover which can be insured is 75% of gross income, less the maximum personal rate of the State Illness Benefit.

  However, IP cover is not widely available; some individuals engaged in manual type activities, may not be able to get IP cover.

- **Serious Illness cover** pays out a capital lump sum (not liable to Income Tax) in the event of the confirmed medical diagnosis of a Serious Illness covered by the policy. In this case, it would be necessary to convert a potential earned income loss into a capital sum, as outlined above for life assurance cover.



These two protection products are not alternatives to each other; some clients may have a need for both:

- **IP to cover loss of gross earned income.**
  This is particularly important for the self-employed, who pay Class S PRSI, as they have no entitlement to State Illness Benefit in the event of short-term ill health. Their own earned income could dry up very rapidly if they were off work sick for a prolonged period. The self-employed are entitled to the State Invalidity Pension in the event of becoming permanently incapable of work again.

- **Serious Illness cover to provide a lump sum**, which might be needed for a particular purpose, for example, pay for expensive medical treatment, repay loans, invest to provide additional income, etc.

It is sensible, in most cases, to add Serious Illness cover, on an accelerated basis, to Mortgage Protection and any other loan cover to ensure that loans will be repaid in the event of the onset of a serious illness, provided of course the consumer can afford the substantially increased premium.

Where it is proposed to use Serious Illness cover, rather than IP, to cover loss of earned income it is more difficult to arrive at a precise level of cover needed because:

- The extent of the financial loss may be unpredictable, due to uncertainty about the period of illness and its impact on the individual's capacity to continue to earn income.

- The period of sickness or disability cannot be predicted. For example, it could run from a few weeks, for a relatively minor illness, to permanent incapacity as a result of a car crash or stroke.

- There may not be a permanent or total loss of income in the event of serious illness. For example:

  - An employer may provide sick pay, for a period.

  - The consumer may be entitled to ongoing State Illness/Invalidity Benefits.

    For example, the self-employed can potentially claim the State Invalidity Pension, if they become permanently unable to work again.

  - The consumer may recover and get back to work, either at their own job or in a part time position. For example, the consumer could have a heart bypass operation and recover and go back to work, after a relatively short period.

    For some other illnesses, the consumer might be able to take up some other less stressful work, or work part time, and so the loss of income may be only partial.

So, the multiple approach suggested for life assurance may not be appropriate for Serious Illness cover due to the uncertainties outlined above in quantifying the loss of income arising from serious illness.

For many clients, a combination of adequate IP cover, combined with a level of Serious Illness cover, may lead to the best fit, in terms of protecting the consumer from a loss of earned income caused by serious illness:

- The self-employed should ideally protect at least 66% of their gross earnings with an IP policy. The premiums are tax deductible to an annual limit of 10% of total income.

- Mortgage Protection and other loan cover should, if the consumer can afford the substantially increased premium, include accelerated Serious Illness cover, to ensure that the loan would be repaid in the event of serious illness.

- Life assurance protection cover should, if the consumer can afford the increased premium, include some element of accelerated Serious Illness cover, particularly for employees who have little or no long-term sick pay entitlement from their employer.

- Consumers who already have adequate levels of life assurance cover, but no Serious Illness cover, should consider some level of standalone Serious Illness cover, particularly for employees who have little or no long-term sick pay entitlement from their employer and/or have loans that are not protected against the impact of serious ill health.

- Employees who have little or no long-term sick pay entitlement from their employer should consider protecting part of their income through an individual IP policy.

Review

Now consider the main teaching points, which were introduced in this Chapter. They are listed below. Tick each one as you go through them.

- [ ] Protection needs
- [ ] Quantifying Life Assurance cover required
- [ ] Quantifying Serious Illness cover required

Sample Questions

The answers to these questions can be found in your Study Hub.

1. Andrea is in receipt of a State Widow's Contributory Pension. This pension will stop immediately:

   A. when she reaches age 60.
   B. if she remarries.
   C. if she stops paying PRSI.
   D. if she voluntarily gives up work.

2. Which of the following inheritances received by Shane from his deceased wife, Jackie, are exempt from Inheritance Tax?

   (i) The proceeds of a life assurance policy on Jackie.
   (ii) An investment property owned by Jackie.
   (iii) The proceeds of a PRSA held by Jackie.

   A. (i) only.
   B. (iii) only.
   C. (ii) and (iii) only.
   D. (i), (ii) and (iii).

3. The State Illness Benefit is:

   A. not liable to income tax, PRSI or USC.
   B. liable to income tax, USC and PRSI.
   C. liable to income tax and USC, but not PRSI.
   D. liable to income tax only.

4. The State Invalidity Pension is NOT payable to which of the following?

   (i) The self-employed who pay Class S PRSI.
   (ii) Public service employees who joined the public service before 6th April 1995.
   (iii) Part-time employees in the private sector.

   A. (i) only.
   B. (ii) only.
   C. (i) and (ii) only.
   D. (i), (ii) and (iii).

05

Wills and Estates

Estate Planning knowledge is a key skill required to professionally advise clients on financial planning. This Chapter explains how a deceased's estate will be distributed if they die **testate**, i.e. leaving a valid Will, and if they die **intestate**, i.e. without leaving a valid Will.

This Chapter also looks at benefits and assets which can transfer to survivors, outside of a deceased's estate.

Learning Outcomes – after studying this chapter you should be able to explain:
how legal ownership of assets transfers on death;
the different ways a life assurance policy can be arranged;
the difference between joint tenants and tenants in common;
the requirements to make a valid Will;
Succession Act rights of a deceased's spouse/civil partner and children to the deceased's estate; and
how certain assets can transfer on death to survivors, without going through the deceased's estate.

Chapter weightings	**Number of questions which may appear**		
In the exam, questions are taken from each Chapter based on the following approximate chart:	Chapter	Minimum	Maximum
	5	7	9

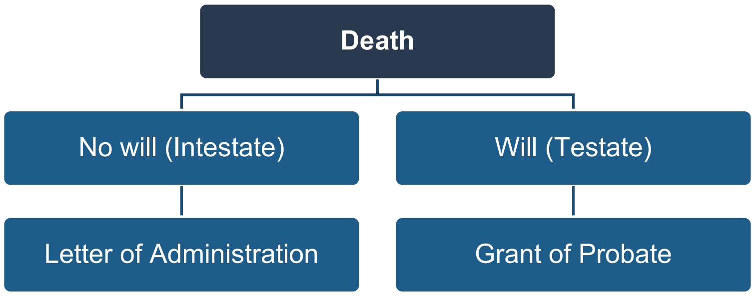
5.1 Estate

When a person dies, legal ownership of all assets they owned solely in their own name transfers to their legal **personal representatives**. Such assets are usually referred to as the deceased's **estate**.

5.1.1 Legal Personal Representatives

The legal personal representatives of a deceased person are appointed by the High Court:

- When a person dies without leaving a valid Will, their next of kin seek **letters of administration** from the High Court.
- Where a person dies leaving a valid Will, in their will they nominate one or more persons to be **executors** of their estate. The executor(s) seek a **Grant of Probate** from the High Court.



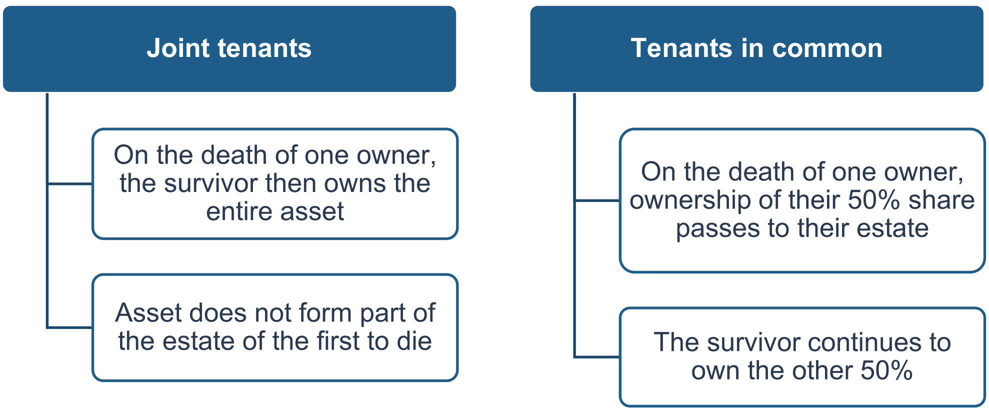
The legal personal representatives appointed by the High Court above secure the deceased's funds and assets, pay off debts and funeral expenses, and then distribute the balance of the estate to beneficiaries according to:

- The deceased's Will, where he or she left a valid Will, referred to as dying **testate**; or
- The Succession Act, 1965, where he or she died without leaving a valid Will, referred to as dying **intestate**.

However, where an individual dies leaving a Will, but their Will fails to deal with some assets, then those assets referred to in the Will shall be distributed according to their Will, but the other assets not mentioned or dealt with in the Will shall be distributed according to the Succession Act. It is therefore possible in some cases that an individual with a Will can die partially intestate.

5.1.2 Jointly Owned Assets

In general, there are two different legal ways in which assets can be jointly owned:



Where an asset is jointly owned by spouses/civil partners, it is legally presumed to be owned by them as **joint tenants**, so that on the death of the first to die, the other spouse automatically becomes entitled to the full legal and beneficial ownership of the asset. The asset does not transfer through the deceased's estate.

Example #1

David and Clint, who are married to each other, own a house in joint names, as joint tenants.

In the event of the death of, say, David, his husband Clint would automatically become the full owner of the house. The house would **not** go through David's estate.

An alternative form of joint ownership is where assets are held as **tenants in common**, i.e., where each owner's share of the asset is separate and distinct from the other owner's share, and so forms part of their estate on death and does not pass automatically to the other joint owner on death.

Example #2

Tom and Mick are brothers and own an investment property in joint names, as tenants in common. They contributed equally to the cost of purchasing the property.

On Tom's death, Tom's 50% share of the property goes to his own estate and does not pass automatically to Mick.

Mick continues to own the other 50%.

Property will normally be assumed to be held as **tenants in common**, where the parties involved are not married or civil partners to each other and where each has contributed separately to the capital invested in or cost of acquiring the asset.

5.1.3 Life Assurance Policies

There are several different ways in which a life assurance policy can be arranged and owned. Consequently, not all life assurance cover payable on death will end up in the life assured's estate on death.

How the policy is arranged	Who is the money payable to?
Single life The policyholder and life assured are the same person. This is called an **own life** policy. Policy not assigned or written under trust.	The life assurance cover is payable to the deceased's estate on death, subject to Grant of Probate or Letters of Administration as the case may be.
Life of another The policyholder and life assured are different persons, for example, A holds a policy on B's life. This is called a **life of another** policy. Policy not assigned or written under trust.	The life assurance cover is payable to the policyholder on the death of the life assured, subject only to proof of death, e.g. Death Certificate.

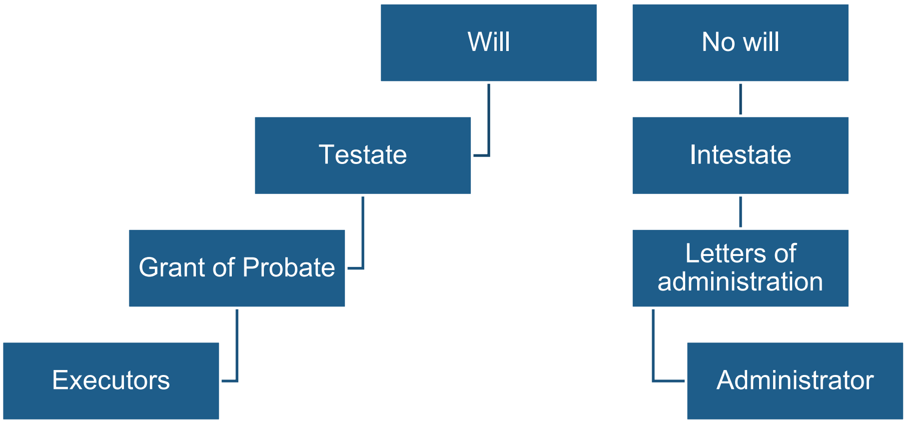
How the policy is arranged	Who is the money payable to?
Joint life first death The policy is owned by the couple as joint tenants. Policy not assigned or written under trust.	The life assurance cover is payable to the surviving policyholder on the death of the first to die, subject only to proof of death, e.g. Death Certificate.
Dual lives The policy is owned by the couple as joint tenants. Policy not assigned or written under trust.	The life assurance cover on the first to die is payable to the surviving policyholder, , subject only to proof of death, e.g. Death Certificate. If the policy is continued by the survivor, the life assurance cover on their life is payable on later death to the estate of the last to die, subject to Grant of Probate or Letters of Administration as the case may be.
Joint life last survivor The policy is owned by the couple as joint tenants. Policy not assigned or written under trust.	On first death, no payment is made. Full ownership of policy passes to the surviving policyholder. The life assurance cover is payable to the estate of the last to die, subject to Grant of Probate or Letters of Administration as the case may be.
Assigned policies E.g. where a policy is assigned or mortgaged to a lender, as security for a loan, for example, Mortgage Protection policy.	The life assurance cover is payable to the assignee, typically a lender, on proof of death, e.g. Death Certificate. Any surplus after paying off the mortgage, is returned to the surviving policyholder, if any, or if none to the life assured’s estate, subject to Grant of Probate or Letters of Administration as the case may be.
Policy written in trust Policy is written under a **Declaration of Trust** and is legally owned by the appointed trustees. Example, joint life last survivor Whole of Life policy arranged under Section 72 for Inheritance Tax purposes. Arranged under a Declaration of Trust.	The life assurance cover is payable to the appointed trustees (subject only to Proof of Death), who must then distribute the proceeds to the trust beneficiaries in accordance with the terms of the Declaration of Trust signed by the policyholder(s) at the time the policy was taken out.

In a lot of cases, therefore, the life assurance cover payable on death may not be paid to the deceased estate; it may be paid directly to other persons.

5.2 Wills

5.2.1 Why Make a Will?

An individual who dies leaving a valid Will is referred to as the **testator**. A female who has made a valid Will is sometimes referred to as a **testatrix**, but the term testator tends to be commonly used to refer to both males and females who die leaving a valid Will.



In some cases, there may be no need to make a Will where all of an individual's assets are held as joint tenants with their spouse; on death their spouse will automatically take over ownership of all such assets. If both parties in a couple were to die at the same time, for example, in a plane or car crash, their assets would then have to go through their respective estate to their next of kin. So, a Will is generally always advisable, even if all assets are held as joint tenants.

There are several good reasons why any individual should make a Will, and indeed should regularly review their Will:

- By making a Will the individual's estate will be distributed according to their wishes. For example, an individual might want to leave a business or farm to one specific child who is involved in the family business or farm, etc.

- The individual can appoint legal guardians for children, should both parents die when their children are minors.

- It allows individuals with substantial assets to plan to mitigate, as far as possible, possible Inheritance Tax liabilities that might arise on their death for their children and others. For example, an individual can leave their entire estate to their spouse, free of Inheritance Tax.

- Generally speaking, there is less legal delay and dispute for dependants, when a person dies leaving a valid Will rather than where no Will is left.

5.2.2 Legal Requirements

There are certain legal requirements in order that a Will is legally valid:

- A Will can be made by any person who is over age 18, or is or has been married, and is of *sound disposing mind*.

- A Will must be *in writing.* This term can be taken to include printed or typed Wills. No special form of words need be used in the Will although obviously a solicitor drafting a Will must use certain legal terms to avoid ambiguity.

- The Will must be signed at the end by the testator, i.e., the person making the Will, in the presence of each of two or more witnesses present at the same time.

- The witnesses must also sign the Will in the presence of the testator to testify the testator's signature. They do **not** have to read the Will nor is it necessary for them to know what is contained in the Will.

- Witnesses, or their spouses/civil partners if they are married or civil partners at the time the Will is made, cannot benefit under the Will they have witnessed. A spouse of a witness can benefit under the Will if the witness gets married *after* making the Will.

  Normally where the Will is made in a solicitor's office, the solicitor and possibly one of their staff will witness it as they will not usually benefit under it.

- The testator will normally appoint one or more executors in the Will.

Making a Will is best handled by a solicitor. 'Home-made' Wills can be dangerous and lead to legal disputes after death if the wording is unclear.

5.2.3 Codicil

A **Codicil** is a name given to an **amendment** made to an existing valid Will, sometime after the Will is made. Rather than having to make a brand-new Will, a codicil simply changes some particular aspect of the Will.

Example

Joe makes a valid Will, and leaves half of his estate to his spouse, some assets to his children, and leaves a particular asset to a nephew.

Some years later Joe changes his mind about the bequest to the nephew and executes a Codicil which revokes the bequest to the nephew and directs that the particular asset is, for example, to be shared between his children, or left to some specific child, or whatever his revised intention is.

A Codicil must be proven in the same way as the Will, that is:

- It must be signed at the end by the testator in the presence of each of two or more witnesses present at the same time;

- Each witness must attest to the testator's signature, by signing the Codicil also; and,

- A witness cannot benefit under the Will or Codicil, and any bequest to a witness is invalid.

A Codicil does **not** revoke the Will already made, but simply changes some aspect of it. The individual's Will on death is therefore taken as the combination of the original Will and the Codicil(s) made after the Will.

5.2.4 Revoking a Will

Of course, an individual's circumstances can change over time. A Will made years ago may no longer be appropriate today because, for example, the individual may have children now or more children now, or maybe their spouse has died in the meantime, or they have divorced.

A Will can be revoked in several different ways:

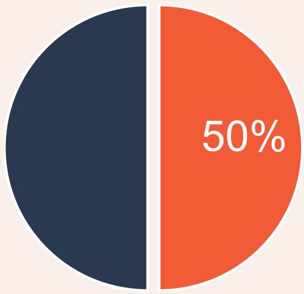
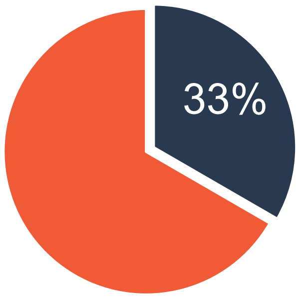
- **By making a new Will.** It is standard practice to insert a clause at the start of a Will to say that 'this Will revokes all previous Wills'. If, therefore, an individual makes a new Will and signs it this will automatically cancel any previous Will.

- **A Will made by an individual when he is single is automatically revoked by their subsequent marriage**. However, a Will made by the individual shortly before marriage '*in contemplation* of that marriage' is not automatically revoked by subsequent marriage.

- **By the destruction of the Will**. A will is automatically revoked 'by the burning, tearing or destruction of it by the testator, or by some person in his presence by his direction, with the intention of revoking it.'

5.2.5 Legal Right Share

While an individual can frame his or her Will in any way they want, the Succession Act, 1965 provides the spouse/civil partner with a **minimum share** of his or her late spouse/civil partner's estate, called the **legal right share**, which they can call on after their spouse/civil partner's death if the deceased's Will has left them less than this legal minimum share:

Surviving	Spouse/civil partner's legal right share under a Will	
Spouse/civil partner only; no children.	**ONE HALF** of the estate, *inclusive* of the family home.	
Spouse/civil partner and children.	**ONE THIRD** of the estate, inclusive of the family home.	

Children of the deceased do **not** have a right to a specific minimum percentage of their parent's estate under a Will.

However, children can apply to the Courts for a share of their parent's estate, on the grounds that their parent failed in their moral duty to make *proper provision* for them in their Will; the Courts can decide to accept or reject the child's petition for a share or a greater share of their parent's estate.

Example

Mary is married to John. They have two adult children.

Mary dies and in her Will she left everything to a distant relative in the US, whom she had not seen for 20 years. She left nothing to John or the two children.

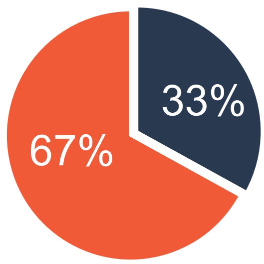
John is entitled to at least 1/3 of Mary's estate, as her surviving spouse.

The children have no right to any specific share of her estate. However, they can apply to the Courts for a share of their mother's estate on the basis that she had failed in her moral duty to make 'proper provision' for them.

If the Courts decide to award the children something, the distant relative will then get the balance, if any, of the bequest.

5.3 No Will

Where a person dies without leaving a valid Will, the Succession Act, 1965 sets out who should inherit from the deceased's estate and in which proportions.

Surviving	Minimum legal share of estate under intestacy	
Spouse/civil partner only; no children.	Spouse/civil partner: 100%.	
Spouse/civil partner and children.	Spouse/civil partner: 67%. Children: 33%, equally between them.	
Children only.	100% equally between the children.	

Example

Joe dies without leaving a valid Will. He leaves a wife and three children.

His estate will be divided up as follows:

- 2/3rds to Joe's wife
- 1/3rd divided equally between the three children, i.e., each child gets 1/9th of Joe's estate.

5.3.1 Cohabitants

A cohabitant couple is a couple who are not married or civil partners to each other. Cohabitants do not have any Succession Act rights to each other's estate on death.

However, it may be that assets owned by such cohabitants are held as joint tenants in which case the survivor would automatically fully such assets in any event, without going through the deceased's estate.

Of course, an individual can in his or her Will leave assets specifically to his or her co-habitant or to any other individual**.**

However, if the individual has a spouse, civil partner and/or children at the date of death, these parties could claim their Succession Act legal rights to part of the estate, which might have the effect of reducing the inheritance left to the deceased's surviving co-habitant.

If an individual has a co-habitant and dies without leaving a Will, the surviving cohabitant has **no** legal right to any share of the deceased's estate.

5.3.2 Legal Separation

After separation, the married couple are still seen in the eyes of the law as being married to each other.

However, as part of a legal separation:

- One spouse may agree to renounce their Succession Act rights to the other's estate, or

- A spouse may seek (and obtain if the court decides) a court order extinguishing the other spouse's Succession Act rights to their estate.

5.3.3 Divorce

A Decree of Divorce **automatically** extinguishes the Succession Act rights of each spouse to their spouse's estate, as following the decree the couple are legally no longer married to each other.

However, following the subsequent death of one of the divorced couple, the surviving ex-spouse can apply to the Courts for a share of the deceased's estate. The Court might grant the survivor some share of the deceased's estate if the court feels that the deceased had not made proper financial provision for their ex-spouse during his or her lifetime.

A divorce does not extinguish or change in any way children's Succession Act rights to either parent's estate.

5.3.4 Benefits Passing Outside Estate

Note that Succession Act rights under a Will or intestacy, do **not** apply to benefits passing outside the deceased's estate after death, such as:

- Assets held as *joint tenants*, for example:

  - Family home owned jointly by a husband and wife. On first death, full legal ownership of the home passes to surviving spouse.

  - Joint life first death life and dual life policies, where the benefit payable on the first death is paid direct to the surviving policyholder.

  - Jointly held bank deposits, where the deposit is held as joint tenants. On the first death, legal and beneficial ownership of the account passes to the surviving account holder.

- Life of another death benefit payments, where the policy benefit on death of the life assured is paid direct to the policyholder.

- Death benefit under a life policy written in trust for beneficiaries, where the benefit is paid to the trustees for distribution in accordance with the terms of the trust.

- Employer pension scheme death benefits, paid by the trustees of the scheme directly to beneficiaries (usually as nominated by the individual through a letter of wishes).

- Credit Union savings which may be paid directly to certain beneficiaries after death, without going through the deceased's estate (see section 5.4 following).

5.4 Credit Union Savings

The Credit Union Act, 1997 allows credit unions to pay a deceased member's funds in the credit union (savings, loans, insurances, etc directly to certain individuals outside the deceased's estate in certain circumstances:

- **Under a nomination (up to €23,000).**

  A credit union member over the age of 16 may nominate a person or persons in his or her family to become entitled to their credit union funds following their death.

  The nomination is valid only up to a current limit of €23,000. Any funds in excess of that can only be paid by the credit union to the deceased's estate, subject to receipt of Grant of Probate or Letters of Administration, as the case may be.

- **Funds less than €15,000, not under a nomination.**

  Where a member of a credit union dies and he or she held €15,000 or less in credit union funds at the time of death, the board of the credit union can distribute the funds to such persons as they believe are entitled *by law* to receive it without requiring Grant of Probate or Letters of Administration, provided there is not a valid nomination over the same funds.

  In this case, the credit union board may only distribute the funds among such persons as are entitled *by law* to receive it. Who is entitled to the funds is therefore dependent on whether or not the deceased died leaving a valid Will, and if so the terms of the Will.

Example #1

Zuzana is a member of her local credit union. She has shares in the credit union. She has not completed a nomination.

Her balance in the credit union at the date of death, after adding in credit union insurance, is €14,500. Zuzana left a Will leaving everything to her wife, Fiona.

The credit union can pay the €14,500 to Fiona subject to receipt of proof of Zuzana's death, Fiona's identity as Zuzana's spouse, and receipt of a copy of Zuzana's will. The credit union does not require a Grant of Probate.

Where the member's credit union funds exceed €15,000 at the date of death, payment of the full funds is dependent on Grant of Probate or Letters of Administration, as the case may be, unless the member has left a valid nomination.

Example #2

Zuzana is a member of her local credit union. She has shares in the credit union. She has not completed a nomination.

Her balance in the credit union at the date of death, after adding in credit union insurance, is €16,000. Zuzana's wife predeceased her, and she left two adult sons, Mark and Szymon. Zuzana did not leave a Will.

The credit union can only pay the €16,000 to Zuzana's estate and hence will require Letters of Administration before payment.

Review

Now consider the main teaching points, which were introduced in this Chapter. They are listed below. Tick each one as you go through them.

- [ ] An individual's estate and legal personal representatives
- [ ] The distribution of jointly owned assets on death
- [ ] The distribution of life assurance cover payable on death
- [ ] The requirement to make a valid Will
- [ ] The main Succession Act rights which the next of kin of a deceased may have to his or her estate under a Will and intestacy
- [ ] The possible impact on a spouse or civil partner's Succession Act rights of a legal separation or divorce
- [ ] Credit Union savings paid outside a deceased's member estate

Sample Questions

The answers to these questions can be found in your Study Hub.

1. Harry died leaving a Will. What document must his executor(s) obtain in order to gain legal ownership of Harry's assets?

   A. Grant of Probate.
   B. Deed of assignment.
   C. Letter of Administration.
   D. Deed of Executorship.

2. Owen and Emma are married to each other and own their family home in joint names, so that if one of them dies the other automatically gets full legal ownership of the home. This type of joint legal ownership is called:

   A. tenants in common.
   B. life tenants.
   C. full tenants.
   D. joint tenants.

3. Niall, who is single, made a Will some years ago. His Will is revoked if he:

   (i) makes a new Will.
   (ii) marries.
   (iii) changes his domicile to another country.

   A. (i) only.
   B. (i) and (ii) only.
   C. (ii) and (iii) only.
   D. (i), (ii) and (iii).

4. If Enda dies leaving no Will and is survived by his wife and one child, what MINIMUM share of Enda's estate is his child entitled to?

   A. 25%
   B. 33%
   C. 50%
   D. 66.66%

06

Business Insurances

This Chapter looks at different types of business structures and associated business uses of life assurance and Serious Illness cover, including Partnership Insurance and Keyperson Insurance.

Learning Outcomes – after studying this chapter you should be able to:
define the two main types of business structures, partnerships and private limited companies;
explain the difference between a Limited Liability Partnership and an Unlimited Liability Partnership.
explain the need for life assurance and Serious Illness cover as part of a business arrangement, including partnership (or co-directors) insurance and Keyperson Insurance; and
explain the two different ways to arrange Partnership Insurance, and the advantages and disadvantages of each, including the taxation implications for the partners involved.

Chapter weightings	Number of questions which may appear		
In the exam, questions are taken from each Chapter based on the following approximate chart:	Chapter	Minimum	Maximum
	6	5	7

So far, we have considered individuals taking out life assurance and Serious Illness cover to provide financial protection for themselves and their dependants.

However, in certain circumstances, life assurance and/or serious illness cover may be needed as part of a business arrangement.

We consider two such uses of protection policies in this Chapter:

Partnership Insurance	Keyperson Insurance

Before considering these, we will first look at the two main types of business structures carried on by a group of people.

6.1 Business Structures

There are two main types of business structures:

Partnership	Private limited company

Unlimited Liability Partnership

- A group of two or more individuals carrying on business together with a view to making a profit.

- The partnership does not have a separate legal identity. The profits and losses and debts of the partnership are those of the partners personally, in relation to their share of the partnership. Each partner has unlimited personal liability for the debts of the partnership.

- Each partner is liable to income tax on his or her share of the partnership's profits regardless of whether or not the partner withdraws these profits from the partnership. Each partner is therefore subject to self-assessment for income tax purposes, on his or her share of the partnership profits.

- Each partner's share of the partnership profits is subject to income tax under Schedule D, Case **I** or **II**, and is therefore treated as '**relevant earnings'** against which income tax relief (but not for USC or PRSI) can be obtained in respect of pension contributions within limits.

- Each partner is personally fully liable for the actions of the other partners carrying on business in the name of the firm and can be bound by the actions of any of the partners.

- A partnership may have a written partnership agreement setting out the rights and duties of partners and covering the procedures applying on the death, retirement and accession of partners.

- In the absence of a written or oral partnership agreement the provisions of the Partnership Act 1890, apply:

  - The death of a partner gives rise to the dissolution of the partnership and entitles the remaining partners to realise the partnership assets.

  - All partners are entitled to share equally in the capital and profits or losses of the business.

  - The liability of each partner for the debts of the partnership is unlimited.

Limited Liability Legal Partnerships

Partners in a law firm can choose to operate as a Limited Liability Partnership (LLP) where the partner is not personally liable for the partnership debts or liabilities etc. However, the limited liability protection does not apply to a partner:

- Where the partnership debt or obligation was due to an act or omission of the partner involving fraud or dishonesty;
- In respect of their taxation liabilities;
- Where the partnership debt or obligation was incurred by that partner for a purpose not connected with the carrying on of the business of the limited liability partnership.

Private Limited Company

- A private limited company is a separate legal entity with a legal personality distinct from that of its owners. It can sue and be sued in law.
- The liability of the members (i.e., shareholders) is limited to the amount which they have agreed to pay for the shares in the company. The shareholders own the company by virtue of their ownership of the share capital although the legal ownership of the company's assets rests with the company itself and not with the shareholders.
- Shareholders have the right to receive dividends from the company and to share in any surplus of the company's assets following a wind up or liquidation of the company.
- Most private companies are a company limited by shares, or Limited or LTD for short. Under the Companies Act 2014, these companies have a one-page constitution document which replaces the need for a Memorandum and Articles of Association.
- Some private companies are **designated activity companies** or DAC for short. These are companies whose activities are limited to specific *objects* or purpose. An example might be a life assurance company. Such companies must have:
    - A document which regulates the company's relationship with the outside world, known as its Memorandum of Association.
    - A document which controls the company's relationship with its own shareholders and the respective rights of shareholders between themselves, known as its
    - Articles of Association.
    - Stated objects for which it was incorporated.
- The company is liable to pay Corporation Tax on any profits or gains it makes.
- Shareholders are liable to income tax under Schedule F in respect of any dividends received from the company.
- A director who works in the company is taxed as an employee under Schedule E in respect of any remuneration taken from the company.
- Proprietary directors are liable to self-assessment on their income in the same way as the self-employed.

As employees of the company, proprietary directors can be included in a pension scheme operated by the company. Any contribution the company makes to the scheme is deductible for Corporation Tax and there is no tax charge on the members in respect of such contributions. Since 1st January 2024, employers can also pay contributions to a PRSA for an employee or director, without that employer or director incurring a benefit-in-kind (BIK) liability. Contributions are not limited by salary or service, existing scheme funding or retained benefits, as pension scheme funding is. They are however limited to the overall pension Standard Fund Threshold (SFT) of €2M and of course, by affordability.

6.2 Partnership Insurance

6.2.1 Overview

Many small businesses are run by two or more individuals working together, either as:

- A **partnership** (i.e., two or more individuals carrying on business together with a view to making a profit); or,

- As **co-directors and shareholders** of a private limited company.

In this section, we use the term *partner* as referring to either a partner in a partnership OR a director/shareholder of a private limited company.

In either structure (partnership or limited company) the sudden death of a partner can cause immediate financial problems for the surviving partners:

- In the case of a partnership, the death of a partner can cause the immediate dissolution of the partnership, unless there is a prior agreement to the contrary.

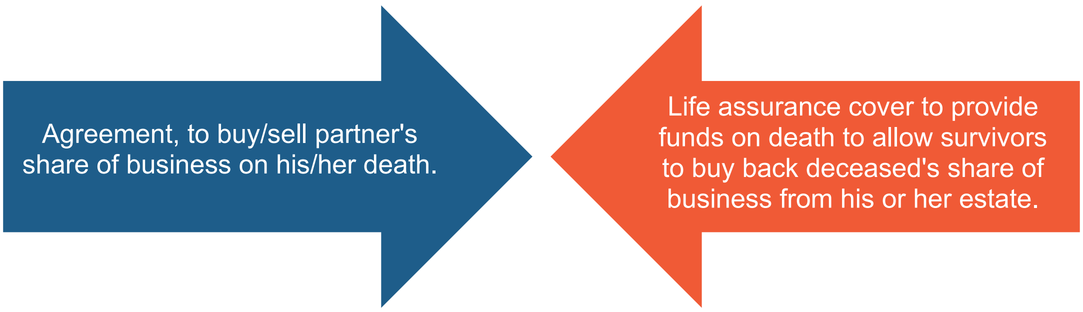
- The next of kin of a deceased partner may want to come into the business with the surviving partners, who might not want this.

- Even if the next of kin are willing to sell their share of the business back to the surviving partners, the surviving partners may not have the liquid capital or the borrowing capacity available to do so at that time.

Partnership Insurance is an arrangement designed to meet the needs outlined above. Although referred to here as **Partnership Insurance,** this term is taken to include both partnerships and shareholders in a private limited company. However, the term **Co-Director's Insurance** is sometimes used to refer to a similar arrangement for directors of a limited company.

6.2.2 Structure of Partnership Insurance

There are two key components to the structure of a Partnership Insurance arrangement:



- A legal agreement, often called a **buy/sell agreement** or sometimes a **double option agreement,** between the partners, under which following the death of a partner, the surviving partners have the right to buy back from his or her estate the deceased's share of the business. The surviving partners therefore will own the entire business after buying back the deceased partner's share, and the deceased's next of kin end up with a capital lump sum.

- To ensure that the surviving partners are in a financial position to complete the transaction, each partner's life is insured for a sum assured equal to the estimated value of their share of the business, in order to provide sufficient liquid capital on death for the surviving partners to buy back their share.

6.2.3 Arranging the Life Cover

The Partnership Insurance life cover can be arranged in one of two ways:

6.2.3.1 Life of Another

In the case of life of another, a partner insures each of his fellow partner's lives for a sum equal to the amount needed by that partner to buy out the deceased partner's share of the business on his or her death. Each policy is arranged on the 'life of another' basis, i.e., where one partner insures another partner's life.

Example

A, B, and C run a business as partners. Each owns 33% of the business.

A is aged 30 on his/her next birthday, B is 40 next birthday and C is 50 next birthday. All are assumed to be non-smokers.

The estimated value of the business is put at €1,200,000, so that each partner's share is valued at €400,000.

The life of another policies (assumed to be Convertible Term Assurance for 20 years for A and B but 15 years (to age 65) for C) would be arranged as follows:

Policy owner	Life assured	Sum assured	Annual premium € pa paid by policy owner
B	A	200,000	182[*]
C	A	200,000	182*
A	B	200,000	259
C	B	200,000	259
A	C	200,000	538
B	C	200,000	538
Total		**1,200,000**	**1,958 pa**

If A dies, B and C will each collect €200,000 under their respective policies on A and will have sufficient funds (€400,000 between them) to buy back A's share of the business (assuming it is then valued at €400,000) from his or her estate. And similarly, if B or C dies first.

Where there are N partners the number of policies required by life of another Partnership Insurance is N x (N-1).
Therefore, there are a total of *six* policies required in this case, with each partner being required to take out two policies, a policy on each of his or her fellow two partners. If there were five partners in total, each partner would have to take out four separate policies, one on each of his or her fellow four partners, i.e., 5 x 4 = 20 policies in total.

Life of Another Advantages and Disadvantages

Advantages

- Correct distribution of cost of cover
- Funds end up in right hands on death

Disadvantages

- A large number of policies may be required
- Inflexible

[*] *Minimum annual premium.*

The **advantages** of the life of another Partnership Insurance arrangement are as follows:

- There is a **correct distribution of the cost of arranging the cover**, i.e., the younger partners pay the higher premiums. This is fair as the younger partners are, from an actuarial point of view, more likely to benefit as the older partners are more likely to die before the younger partners.

Partner	Age	Premium outlay € pa
A	30	797
B	40	720
C	50	441
Total		**1,958 pa**

- The **life assurance policy funds end up in the right hands on death**, i.e., the surviving partners who want to buy back the deceased partner's share of the business.

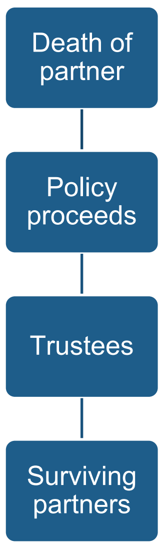
- **The proceeds of the policy are received by the surviving partners without any liability to Inheritance Tax.** As each partner receives the proceeds of the policy on which he or she pays the premiums, the policy proceeds are not liable to Inheritance Tax in their hands.

However, the **disadvantages** of the life of another Partnership Insurance arrangement are:

- **A large number of policies are required**. In general, if there are N partners, N x (N-1) life of other policies will be required in total, in order that each partner is insured for the required amount of cover. If, for example, they are four partners, then 4 x 3, i.e., 12 policies, will be required.

- **The arrangement is inflexible**. If for example, a new partner D. joins, the existing life of another partnership policies would have to be re-jigged totally, in order that each partner is insured by the others for the revised correct amount.

6.2.3.2 Own Life in Trust



In this case, each partner takes out just one policy on their own life, which is arranged under trust for the benefit of the other partners.

On the death of the insured partner, the policy proceeds are paid to trustees who then pay the proceeds to the surviving partners to be used to buy back the deceased's share of the business.

Therefore, this arrangement is called **own life in trust** as each partner effects a policy on their own life, which is written in trust for the benefit of the surviving partners.

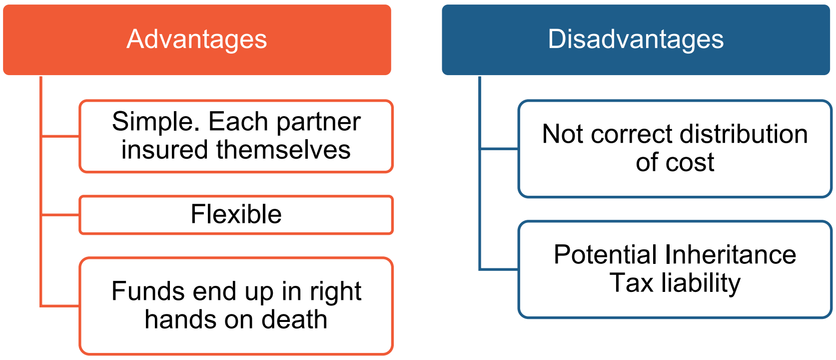
On this basis, using the earlier example, each partner insures their own life for €400,000, with the policy written under a Declaration of Trust for the benefit of the surviving partners.

For example, three policies would be required as follows:

Policy owner	On life assured	Sum assured	Annual premium € pa paid by policy owner
A	A	400,000	283
B	B	400,000	490
C	C	400,000	1,047
Total		**1,200,000**	**1,820**

Therefore, the total cost of the life assurance cover, apart from any differences in policy fees and minimum annual premium, is basically the same as under the life of another basis, as the same total amount of cover on the same lives assured is involved, i.e., €1,200,000 in this example, but the cost of the cover is distributed differently.

Own Life in Trust Advantages and Disadvantages



The **advantages** of arranging the Partnership Insurance policies on an own life in trust basis are as follows:

- **The arrangement is simple**. Each partner takes out just one policy, i.e., a policy on their own life. Therefore, if there are five partners, only five policies are required.

- **The arrangement is flexible**. If, for example, a new partner D joins the business he would, as a partner or shareholder of the business, automatically become a beneficiary under the existing policies and all that would be required would that he or she would insure their life for the appropriate amount of cover for the benefit of the other partners.

- **It provides funds in the right hands on death** i.e., the surviving partners. On the death of any one partner, the proceeds are paid through the nominated trustees to the surviving partners for the purpose of buying back the deceased's share of the business.

However, the **disadvantages** of the own life in trust Partnership Insurance arrangement are:

- **There is not a correct distribution of cost.** In the above example the older partner, C, pays the highest premium while the younger partner, A, pays the lowest premium.

- Because the cost of the arrangement is not equally distributed among the partners **there is a possibility that part of the policy proceeds on death could be liable to Inheritance Tax** in the hands of the surviving partners.

However, the Revenue Commissioners have indicated that no Inheritance Tax will arise on the proceeds of the own life in trust Partnership Insurance policy in the hands of the surviving partners, provided certain conditions are met:

- Each partner is insured only for a sum equivalent to the value of his share of the business.
- Proceeds on death are used by the survivors to purchase the deceased's share of the business. Any surplus funds not used to buy back the deceased's share of the business, are liable to Inheritance Tax.
- The arrangement must be supported by relevant documentation, for example, a buy/sell agreement, a reciprocal agreement to effect and maintain the policies, and a trust document.

6.2.4 Pension Term Assurance

An alternative approach to Partnership Insurance for partnerships, but not for shareholders of a company, is a system called **automatic accrual of goodwill,** that is:

- On death of a partner, no payment is payable by the surviving partners to his or her estate for their share of the partnership value, normally called partnership **goodwill**, i.e., the value of the partnership's good name in generating future profits.

  Instead the value of the partnership goodwill accrues from one generation of partners to another without payment, hence the term '*automatic accrual* of goodwill'. Therefore, the partners benefit from the partnership goodwill through their share of the partnership profits only while they are partners.

- To compensate for the loss of entitlement to payment for partnership goodwill on death, each partner is required to effect a Section 785 life assurance policy (also referred to as pension Term Assurance; see Chapter 2.2.3) on their own life for an agreed level of life cover. This cover is to compensate their dependants for not getting any payment for partnership goodwill following their death.

Example

A, B and C are all in a partnership on a self-employed basis. Their Partnership Agreement provides for no payment on death in respect of goodwill from the practice.

Instead, each partner is bound to effect and maintain a Section 785 policy for a sum assured of €250,000 each, to compensate their dependants for receiving no payment in respect of goodwill from the practice on death.

6.2.5 Payment of Partnership Insurance Premiums

In the case of a Partnership Insurance arrangement involving shareholders in a private limited company, although the subject matter to be bought and sold on death is shares in the company, the arrangement is a **personal** arrangement between the shareholders involved.

Therefore, the company cannot pay the premiums for the shareholder, unless such premiums are to be treated as a benefit in kind (BIK) for income tax purposes for the director involved, subject to PAYE, USC and PRSI.

In the case of automatic accrual of goodwill for partnerships, it is often the case that the total Pension Term Assurance premiums are paid by the partnership on behalf of the partners, to ensure that the policies are maintained:

- The premium paid on behalf of each partner is treated as a personal drawing made by that partner, for income tax purposes. It is therefore added back to that partner's share of the partnership's income, for income tax purposes.

- However, the Pension Term Assurance premium paid for a partner is deductible by that partner for income tax (but not for the USC or PRSI), within the specified limits, so that a partner may be able to claim a matching income tax deduction therefore giving rise to no additional income tax liability but leaving a residual personal liability for USC and PRSI.

6.3 Keyperson Insurance

6.3.1 Overview

As we have seen, a company is a separate legal entity from its shareholders and employees. Therefore, the death of a shareholder or employee does not directly cause the 'death' of the company. Ownership of the deceased's shareholding changes, but the company continues.

However, the death of a *key* shareholder or employee could, in certain circumstances, lead to a financial loss to the company.

Keyperson Insurance is a term used to describe life assurance effected by a company on the life of one of its key employees or directors with a view to compensating the company for an anticipated financial loss of company profits following the death of that individual.

6.3.2 Quantifying the Loss

The death of a key employee or director could cause a financial loss to the company in two different ways:

- **Loans to the company could become repayable**, particularly any loans for which the individual had given a personal guarantee or indeed any loans made by the individual himself to the company which would now be repayable to his or her estate.

- **Loss of profits** caused by the loss of the individual's expertise, experience, contacts and knowledge of the business.

Quantifying the loans that may need to be repaid is easy. It is much more difficult to quantify the loss of profits.

It may be that the individual has a particular expertise or contacts that would be difficult or costly to replace if he/she were to die.

One measure sometimes used is to take a multiple of the individual's remuneration, say between five and ten times remuneration.

However, in the case of small companies this may not give a true reflection of the individual's worth, as it is common for proprietary directors to be in a position to control their taxable salary by minimising their remuneration 'take' from the company. Hence an individual's remuneration may not itself be an accurate reflection of their true worth to the company.

It is important to note that Keyperson Insurance is not meant to generate a windfall profit for the company or to increase its value over what it would have been had the individual not died. It is meant to replace the anticipated loss of profits on the death of the individual.

6.3.3 Arranging the Keyperson Insurance Policy

A Keyperson Insurance policy is a *life of another policy*, with the company as the policyholder and the key director/employee as the life assured.

Normally the directors pass a special resolution at a meeting to authorise the company to affect the policy and to clarify that the policy is being effected for the benefit of the company and NOT for the benefit of the individual's estate.

6.3.4 Taxation

The taxation position of Keyperson Insurance policies is complicated and only a brief outline will be given here:

- If the **sole** purpose of the policy is to repay a company loan or the individual covered is a substantial shareholder in the company, then the premiums are **not** generally deductible for Corporation Tax purposes as a business expense.

- As a general rule, if the premiums do not qualify as an expense deduction for Corporation Tax purpose, then the proceeds on death are treated as a *capital* receipt and **not** liable to Corporation Tax.

- If the premiums have been deducted as an expense for Corporation Tax purpose, then the proceeds on death are treated as a *trading receipt* and would in such circumstances be liable to Corporation Tax as a trading profit at the current Corporation Tax rate applying to trading profits of 12.5%.

- However, even if the premiums have not been deducted as an expense for Corporation Tax purposes, Revenue reserve the right to tax the proceeds as a trading receipt, if they feel the *purpose of the policy* was to replace profits.

Review

Now consider the main teaching points, which were introduced in this Chapter. They are listed below. Tick each one as you go through them.

- [ ] The main legal and taxation differences between a *partnership* and a *limited company*
- [ ] **Partnership Insurance,** the different ways in which it can be arranged and the taxation implications of each way in which it can be arranged
- [ ] **Keyperson Insurance***,* what it is, how it can be arranged and its taxation treatment

Sample Questions

The answers to these questions can be found in your Study Hub.

1. Ian and Alan are partners in a dental practice, which operates as a partnership. Ian is liable to income tax each year on:

   A. his share of the total partnership profits for that year.
   B. the level of drawings he takes out of the partnership in that year.
   C. the average annual level of drawings he took out of the partnership over the last three years.
   D. the full partnership profits declared for that year.

2. In a partnership insurance arrangement for four equal partners aged 40, 43, 48 and 56 organised on a 'life of another' basis with a similar type of policy, who will pay the HIGHEST premium?

   A. The partner aged 40.
   B. The partner aged 42.
   C. The partner aged 48.
   D. The partner aged 56.

3. In relation to a partnership, the term 'automatic accrual of goodwill' means:

   A. on the death of a partner no payment is made by the surviving partners to the deceased partner's estate in respect of partnership goodwill.
   B. on the death of a partner his or her share of the partnership goodwill accrues to his or her estate.
   C. partners leaving the practice are compensated by the remaining partners for their share of the partnership goodwill.
   D. a partner's entitlement to benefit from the partnership goodwill crystallises only when he or she ceases to be a partner.

4. Murphy Windows Ltd has taken out Keyperson Insurance policy on the life of its design manager. The premiums are NOT deductible for Corporation Tax because the:

   A. design manager is aged over 60.
   B. sum assured is more than eight times the design manager's remuneration.
   C. company is the proposer of the policy.
   D. sole purpose of the policy is to repay a company loan.

07

Comparing Protection Cover

This Chapter looks at the headings under which different generic types of life assurance policies may be compared, including comparing similar policies offered by different life assurance companies. Included is a comparison of Convertible Term Assurance v Whole of Life, Individual Mortgage Protection v Group Mortgage Protection, and Income Protection v Serious Illness cover.

Learning Outcomes – after studying this chapter you should be able to:
compare under different headings, different generic types of protection cover to enable you to make a recommendation to a consumer of the most suitable type of cover to meet their identified protection needs.

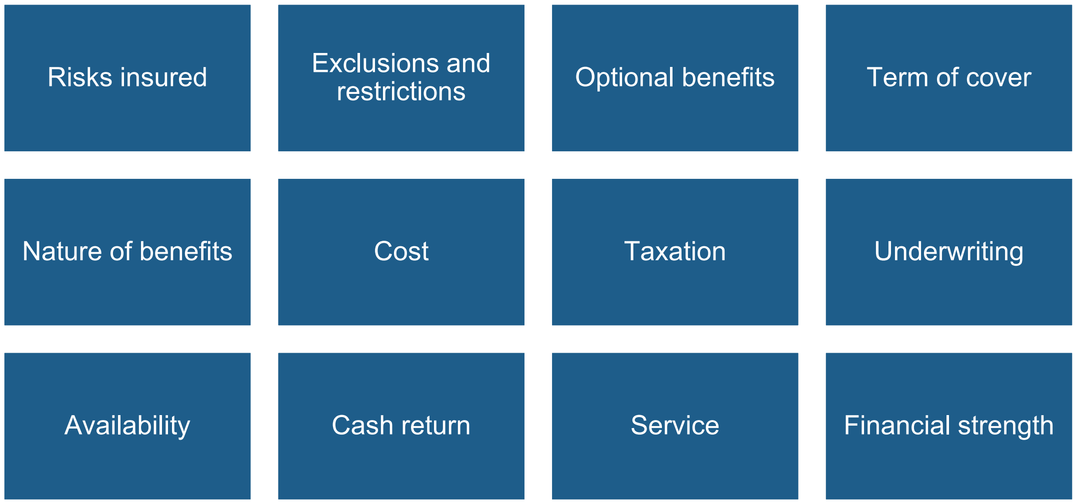
Chapter weightings	**Number of questions which may appear**		
In the exam, questions are taken from each Chapter based on the following approximate chart:	Chapter	Minimum	Maximum
	7	2	4

7.1 Introduction

There are circumstances in which a consumer's protection needs can be met in part or total by more than one type of protection policy, for example, a life assurance need might be met, in the short run, by both a Convertible Term Assurance policy and by Whole of Life cover.

It may therefore be necessary to compare different generic types of protection policies to determine the type of policy or mix of policies which may best meet a consumer's identified protection needs, at the lowest cost.

7.2 Comparison



Protection policies can be looked at and compared under several different headings:

What are the Risks Insured?

What is the event or events being insured against, i.e., what is the risk being covered? The main risks which can be covered include:

- Financial loss for dependants, following death.
- Financial outlay and loss arising from certain serious illness.
- Inability to work due to sickness/disability/accident, short term, leading to a loss of earned income.
- Inability to work due to sickness/disability/accident, long term, leading to a loss of earned income.
- Medical expenses, arising from serious illness.

Some policies may provide a combination of benefits, for example, a policy which provides life and accelerated Serious Illness cover, with optional *rider benefits* such as hospital cash, etc.

The objective is to get the cover package that best meets the client's identified needs. For example, a life cover only policy for a client who only needs life cover, etc, and not take on extra covers at an extra cost when such extra covers are not required by the client.

Exclusions and Restrictions on Cover

Protection policies typically have some exclusions and restrictions on the cover, which could vary from one type of policy to another or from one life company to another. For example:

- A suicide exclusion clause for life cover.
- Territorial limits, where residing outside these areas can invalidate the cover in certain circumstances. The precise territorial limits and allowed periods of residing outside these areas may differ from one insurer to another, and indeed even for policies issued at different times by the same insurer.
- Serious Illness cover restrictions and exclusions: the definition of various illnesses and conditions covered may differ from one insurer to another or indeed between policies issued at different times by the same insurer.
- Exclusions on serious illness and Income Protection cover for claims arising from self-inflicted injuries, etc.

Optional Benefits

Protection policies may offer different optional benefits, sometimes called **rider** benefits, in addition to the main benefit or benefits provided, in return for an increased premium. Examples include:

- A conversion/renewal option.
- An indexation option.
- Waiver of premium.
- Insurability options, for example, right to increase cover without evidence of health on birth of child, increase in mortgage, etc.
- Additional spouse/child cover.

Term of Cover Provided

How long is the cover provided for, or may be provided for?

Some policies may offer a range of possible terms, for example, a Term Assurance or Mortgage Protection policy, while for others the period of cover may be fixed, for example, a short-term sickness and accident policy. A Guaranteed Whole of Life policy offers cover throughout life, but a Unit Linked Whole of Life policy does not guarantee to provide cover throughout life.

The term of cover should ideally be chosen to match the client's maximum period of protection need.

However, there is usually a trade-off between the term of cover provided and the cost to the client. In general life and Serious Illness cover costs more the older you get. Therefore, the longer the term of cover provided, the higher the cost.

Some products, like Convertible Term Assurances, may offer short-term cover at a low cost, but with the option to convert or extend the cover for a further period without fresh evidence of health, i.e., a conversion option. This can enable clients who want long-term cover to pay a lower premium now, but at the expense of paying a higher premium later on if they want to extend the cover.

So, the ability of the client to afford the premium in the short run may dictate the initial period of cover chosen.

Nature of Benefits Provided

Some policies provide in the event of the insured event happening:

- A lump sum payment; others,
- A regular income for a specified period; and others,
- A combination of income and a lump sum payment.

Some policies may specify a maximum level of benefit payable, for example, an IP policy may limit the benefit to (3/4 x earnings – State Illness Benefit) while some serious illness products may have a maximum serious illness pay-out, for example, €500,000, per insured.

In some cases, the benefit may be taxable, for example, an IP benefit, but in most cases risk benefit pay-outs are not subject to exit tax within the life company.

Cost

The premium payable will be determined by a combination of factors:

- The insured's age, smoking status and current state of health.
- The type and amount of cover provided.
- The period of cover provided.

Where the type, amount, and period of cover provided are fixed and identical then in general the most suitable product for the client will be the policy with the lowest premium, assuming all other things are equal.

For example, a client wants €100,000 fixed life cover for 20 years at a fixed cost. Two life companies have quoted these fixed monthly premiums for a 20-year Term Assurance policy providing €100,000 fixed life cover only:

Life Co A: €21.90

Life Co B: €23.50

If we take the view that both life companies are considered to be equally financially sound and equally likely to pay out the sum assured on death, there appears no reason to pay €23.50 pm for something you can get for €21.90 pm, given that both premiums are fixed, the cover is identical in both policies, both are likely to pay out the claim on death, and there are no other benefits.

However, apart from Term Assurance providing life cover only at a fixed premium, a simple comparison of competing protection policy premiums is not valid as the sole means for choosing a policy for the following combination of reasons:

- The type of benefits provided by different policies may differ. For example, in the case of Serious Illness cover the precise illnesses covered, and their respective exclusions and restrictions, may differ between policies.
- Different optional benefits may be added to the policy without any additional cost; the nature of these benefits may vary between policies and insurers.

- While the initial level of cover provided by different policies may be the same, the level of cover provided over the term may differ for a number of reasons, for example:

  - Mortgage Protection policies may be based on different assumed mortgage rates; a policy assuming an 8% pa mortgage interest rate will provide more cover over the term than a policy assuming a 6% pa interest rate.

  - Policies with automatic increases in cover may have different rates of increase in cover and premium and/or different maximum total increase allowed.

  - The term of cover provided by different products may differ. For example, a Term Assurance policy versus a Whole of Life policy.

- There may or may not be a guarantee on the premium and cover. For example, a Term Assurance policy guarantees the premium and cover for the period of the policy, but a Unit Linked While of Life policy may not guarantee the premium or cover beyond the initial premium guarantee period, if any.

- Unit Linked Whole of Life policy premiums are investment return dependant to maintain the premium and cover and hence are subject to investment risk.

  There will be a target investment return required to sustain the cover for life, for a given premium. This target return may differ between policies; for example, Life Co A's unit linked policy may require a fund return, before charges, of 4% pa to maintain the cover for life, but Life Co B may quote a dearer premium which requires a return of 3% pa to maintain the cover for life. Life Co A's quoted premium may appear to be lower than Life Co B's, but it is not necessarily 'cheaper' as it requires an investment return to be sustained, which may not happen.

- Depending on the type of protection policy, there may be a small encashment value if the policy is no longer needed and is encashed, for example, for unit linked protection and guaranteed Whole of Life policies which provide an encashment value. Term Assurance carry no cash value when terminated.

Taxation

Some policies may offer income tax relief on the premium, for example, Income Protection and Section 785 policies do, while others do not.

Policies may also differ in the taxation of the benefit; for example, IP income benefits are liable to income tax under PAYE, while serious illness lump sum payments are not liable to tax in the policyholder's hands.

Underwriting Requirements

Different life companies will have different underwriting requirements for the same individual seeking the same level and type of cover. For example, for a particular level and term of cover, one insurer may automatically require the life assured to undergo a medical examination, while another may only seek a report from their GP.

Therefore, where there is a choice of life companies for similar benefits, a comparison of underwriting requirements should also be considered in comparing policies, as well as cost and benefits provided.

However:

- All life companies reserve the right to seek additional medical information during the underwriting process, in particular in response to answers provided on the proposal form by the individual seeking the cover. E.g. where the individual declares on the proposal form that they had an MRI scan a few months ago.

- Life companies apply their underwriting limits by reference to the total amount of cover a life assured has with the company at that time, and not just on the level of cover now being sought.

- An attempt to spread a large level of cover for a client around the market with different life companies in order, for example, to keep below the medical examination limit with each company will usually be caught by a question on most proposal forms which enquires if the life assured is seeking cover with any other insurer at that time or has sought such cover within the last, say, 12 months. In this case, most life companies will underwrite in relation to the total amount of cover the client is seeking at or around that time, and not just relative to the amount of cover being sought with that insurer.

- Some life companies offer life cover to certain groups, for example over 60s, with no medical questions asked at the proposal stage. However, in this case any death occurring within the first two years of the policy or possibly a longer period is not covered or is not covered fully.

Availability

Different types of policies may not be available to all clients. Examples of restricted availability include:

- Pension Term Assurance can only be taken out by clients who are self-employed or in a non-pensionable employment.

- IP policies are only available to those with a current source of earned income. Therefore, IP cover cannot be obtained by, say, a stay-at-home spouse/partner with no source of earned income.

- Some accident and IP policies might not be offered to certain manual occupations, for example, farmers, etc, or if offered are subject to a significant increase on the premium.

- Serious Illness cover is generally less available than life cover; some life companies impose a maximum age at which they will accept Serious Illness cover applications and may impose a cap on the maximum amount of cover they will offer, particularly where the cover is being provided on Term Assurances at a guaranteed premium.

Cash Return

Does the policy provide any cash return if terminated? Most protection policies do not, as their primary purpose is to provide protection benefits and not a savings return.

Quality of Service

How efficient is one life company over another when the policy is being set up, and, in particular, the speed and efficiency of subsequent claims handling.

Financial Strength

The key here is the level of confidence that a valid claim, if and when it arises, will be paid.

Life companies have very stringent capital requirements to provide a strong buffer against financial shocks, and all companies provide additional reserves over and above the regulatory requirement.

7.3 Convertible Term Assurance Vs Whole of Life Cover

Some protection needs are temporary in nature, for example protecting loss of earned income on death, and hence are generally best met by Term Assurance for a period equal to that of the need.

However, where a protection need is more open ended or possibly a permanent need, there is the option of using either at the *outset*:

The Convertible Term Assurance policy would be converted into a Whole of Life policy at a later date, at a significantly increased premium, to maintain the cover for life.

The big advantage of using the Convertible Term Assurance is a cheaper cost *in the short run*, than guaranteed Whole of Life cover.

However, on conversion to guaranteed Whole of Life later on, the longer-term cost is likely to increase to more than the current Whole of Life premium. Please note that not all companies offer Whole of Life as an option for conversion.

Example

Take a client aged 45, a non-smoker, who needs €300,000 life assurance cover on a long-term basis. The monthly premium quoted by one life company for two options are:

Convertible Term Assurance 20 years: **€54 pm**.

Guaranteed Whole of Life: **€433 pm**.

If this consumer chooses Convertible Term Assurance for 20 years but at age 65 needs to continue the cover, they can then convert into Whole of Life cover. The current cost for a 65-year-old guaranteed Whole of Life cover of €400,000 is about €1,340 pm.

So, the client by choosing Convertible Term Assurance saves in the short run €379 pm, compared to Whole of Life cover, for the first 20-year period to age 65, but may then have to pay some €907 pm **more** for as long as he or she wants to continue the cover.

There is also the risk that when the client wants to convert the Convertible Term Assurance into Whole of Life cover in the future, that the:

- Guaranteed Whole of Life cover might not be offered by that life company at that time.

  OR

- The premium rates for guaranteed Whole of Life cover in the future might be higher than at present; in the example above, we assumed current guaranteed Whole of Life premium for a 65-year-old will apply in 20 years. There is no guarantee what the cost of the guaranteed Whole of Life cover will be in 20 years, when he or she converts from the Convertible Term Assurance.

The Convertible Term Assurance (CTA) cover does have the following **advantages** over the guaranteed Whole of Life cover:

- If the client wants the cheapest possible cost NOW and in the short run, for a given level of cover, then CTA will be more suitable for the client than Whole of Life cover.

- If the client dies during the CTA 20-year term, they will have paid less for their life cover than Whole of Life, but their full protection need will have been met.

- If the need, because of changing circumstances, turns out to be not Whole of Life, then the CTA can be terminated or converted into another shorter-term Term Assurance policy; in this way, the client will have paid less for the cover than under Whole of Life.

7.4 Individual Mortgage Protection Vs Group Mortgage Protection

An individual taking out a housing loan from a lender will usually have the option of either:

- **Effecting an individual Mortgage Protection policy**, with any life company or through any insurance intermediary of the borrower's choice, which can then be assigned to the lender as security for the housing loan.

  Technically this is a mortgage of the policy in favour of the lender, rather than an outright assignment, as the lender is only entitled to recover from the policy the amount it is owed by the borrower at the time of his or her death.

  OR

- **Joining the lender's group Mortgage Protection policy**. The mortgage lender is obliged, under the Consumer Credit Act, 1995, to arrange cover under a group Mortgage Protection policy to cover all its housing loan borrowers, except for the following types of borrowers:

  - Where the house in respect of which the loan is made is *not*, in the lender's opinion, intended to be used as the borrower's principal private residence.

  - Borrowers who are declined by the life company, or who can only get the cover at a '*premium significantly higher than that payable by borrowers generally'.*

  - Borrowers who are over age 50 at the time the loan is approved, or

  - Borrowers who '…*at the time the loan is made, have otherwise arranged life assurance'* providing for the full repayment of the outstanding mortgage on death, for example, arrange their own individual Mortgage Protection policy.

  In the case of joint borrowers and Group Mortgage Protection cover, the lender must include '*such of the borrowers as may be designated by the mortgage lender, due regard being had to the wishes of such borrowers*.' However usually the lender will require both borrowers to be covered.

From the borrower's perspective, there are a number of **potential advantages in using an individual Mortgage Protection policy** to cover a mortgage, rather than join the lender's group Mortgage Protection policy:

Can search the market for the most competitive Mortgage Protection policy available at that time.

- Under group Mortgage Protection cover there is usually no choice of life company; you have to use the life company chosen by the lender.

Can take the cover to a new lender, if the borrower moves mortgage later on.

- If the borrower wants to move their mortgage later to a new lender, they can repay the first lender who will then release the assignment on the individual policy, and the borrower can then bring the policy to the new lender to cover the new mortgage.
- Under group Mortgage Protection cover, the cover is owned by the lender; if the borrower moves their mortgage to a new lender, the cover ceases immediately. The borrow will have to take out a new policy with a new life assurance company to cover their new mortgage.

If mortgage interest rates turn out lower than assumed in the policy, there may be a small surplus for dependants on death, after paying off the mortgage.

Can choose to add optional benefits, which may not be available on Group Mortgage Protection policy.

On the other hand, from the borrower's perspective there are a number of **potential advantages in using Group Mortgage Protection** rather than take out an individual Mortgage Protection policy:

Group Mortgage Protection cover is not interest rate sensitive.

- Each borrower is covered for the principal outstanding from year to year, regardless of changes in mortgage interest rates over the term of the mortgage, assuming all repayments have been made on time.
- Under an individual policy, the cover might not be sufficient to pay off the mortgage in full if mortgage rates are higher than allowed for in the policy.

Group Mortgage Protection cover may cover arrears to a limited extent.

- An individual Mortgage Protection cover will not cover any level of arrears.

Of course, the **cost** of each type of cover, i.e. Individual and Group, should also be compared.

7.5 Income Protection Vs Serious Illness Cover

Serious Illness cover and Income Protection (IP) both provide protection against financial loss arising from ill health, but they cover different risks and in a different way:

	Income Protection	Serious Illness cover
Benefit provided	An income. Usually a maximum benefit is specified, for example, 3/4 pre-illness income less social welfare illness benefit, subject to a maximum upper limit. All illnesses and injuries are covered, apart from those specifically excluded.	A once off lump sum. Life company may not offer cover beyond a specific monetary limit. Only covers specific illnesses.
Taxation	Benefit is liable to income tax. Income tax relief on premiums at marginal rate up to 10% of total income.	No tax liability on lump sum benefit. No income tax relief on premiums.
When is benefit payable?	Loss of earned income due to inability to follow own occupation, lasting longer than a deferred period, usually 26 weeks. All illnesses and disabilities covered, apart from specific exclusions. Must meet ongoing test for continued payments.	No loss of income test or requirement to be unable to work for most illnesses. Payable on confirmed medical diagnosis of specific illness covered by policy. However, PTD (permanent total disablement) benefit does require an inability to work. Benefit payment subject to once-off test only.
Restriction on benefit payment	Benefit payment is usually limited to 75% of pre illness earned income less the single persons' maximum rate of State Illness Benefit. The client could therefore pay for cover which in some circumstances they cannot fully benefit from.	Underwriting may limit the amount of cover offered at the outset. Once cover is set up, it is payable in full if the required circumstances for payment are met.

	Income Protection	Serious Illness cover
Term of cover	Usually to a maximum of age 60, 65 or 70.	Policy term subject to an upper age limit. However, cover for some illnesses (for example, permanent total disability (PTD)) may cease at an earlier age limit, for example, 60/65.
Availability	Only for those with earned income, as benefit is only payable where there is a loss of earned income due to an inability to work due to sickness/disability. Group IP may be available under employer/trade union schemes. Also, some occupations are not acceptable for cover, or are subject to a loading. Cover can be invalidated by later change of occupation or place of residence.	Wide. Not restricted to those with earned income. Can be bought on standalone basis, or with life cover. Apart from PTD, most illnesses covered are not occupational related. Cover can be invalidated by later change of occupation or place of residence.
Cost	Cost usually varies by occupation class. Income tax relief at marginal rate up to 10% of total income reduces the gross cost.	Accelerated cover is cheaper than standalone life & serious illness cover.

IP and Serious Illness cover are two different types of cover, as can be seen from the above comparison, although they both broadly protect against serious illness.

For most people, the ideal is to have a mix of both, particularly for the self-employed who have no entitlement to employer sick pay or the short-term State Illness Benefit.

IP coverage is wider than serious illness, in that payment of benefit is not restricted to sickness or disability arising from specific serious illnesses. For example, Serious Illness cover does not cover being off work for a year due to a slipped disc, or some such other non-life-threatening illness or disability, whereas IP would, if it leads to an inability to work for a prolonged period and a consequent loss of earned income.

As IP insures a loss of earned income arising from sickness or disability, it is only available to people with such income, i.e. income arising from an employment, occupation or trade.

Therefore, for example, IP cover would be of no value to someone who has no earned income and therefore would incur no loss of earned income in the event of sickness or disability.

Serious Illness cover, on the other hand, can be taken out by such individuals, as payment of benefit is dependant only on a confirmed medical diagnosis of an illness covered by the policy. In general, self-employed will have a need for both types of cover.

Review

Now consider the main teaching points, which were introduced in this Chapter. They are listed below. Tick each one as you go through them.

- [ ] Comparing protection policies
- [ ] Convertible Term Assurance v Whole of Life assurance
- [ ] Individual Mortgage Protection v Group Mortgage Protection cover
- [ ] IP v Serious Illness cover

Sample Questions

The answers to these questions can be found in your Study Hub.

1. Which one of the following borrowers is a bank NOT required to include in their group mortgage protection policy, when providing a home loan to that borrower?

A. Sean, aged 43, who is trading up to a new home.
B. A young couple who are not married to each other, borrowing to buy their first home.
C. Noel, aged 52, who is moving home to a bigger house.
D. Joseph, who is borrowing to buy an apartment to live in.

2. Which benefit is usually specifically covered, to a limited extent, by a group mortgage protection policy but NOT by an individual mortgage protection policy?

A. Loan arrears.
B. Death within the first three months of the policy.
C. Death by suicide, after the cover has been in force for a specified minimum period.
D. Redundancy cover.

3. Which one of the following is a potential benefit to a borrower of an individual mortgage protection policy over group mortgage protection cover?

A. Income tax relief on the premium.
B. Mortgage arrears will be covered.
C. The borrower can bring the policy with them to a new lender.
D. They can pay the premium with their mortgage repayments to the lender.

08

Investment Bonds

In this Chapter, we examine single premium life assurance investment policies, usually referred to as 'Investment Bonds 'or 'Bonds', how they are structured through the use of unit linked funds to provide an investment return to investors. Tracker Bonds are also introduced in this Chapter.

Learning Outcomes – after studying this chapter you should be able to:
explain unit linked investment bonds including: - the typical charging structures used. - the main types of investment funds offered, and different investment management style. - the different types of investment risk and the risk/return rating for different types of funds. - fund switching and partial encashments. - how to calculate a unit price. - the taxation treatment of returns earned by an investor in such bonds.
explain life assurance Tracker Bonds and how they are structured.
set out the benefits, limitations and risks associated with unit linked investment bonds and life assurance Tracker Bonds.
explain the various headings under which each type of investment bonds can be compared.

Chapter weightings	**Number of questions which may appear**		
In the exam, questions are taken from each Chapter based on the following approximate chart:	Chapter	Minimum	Maximum
	8	15	19

8.1 Unit Linked Investment Bonds

A **unit linked investment bond** is a single premium Whole of Life policy, where a lump sum (sometimes called a **single premium)** is invested to buy units in one or more investment funds (called **unit funds**) operated by the life assurance company.

The purpose of the bond is to provide an investment return on the lump sum invested, consistent with the client's attitude to and capacity for investment risk.

The minimum initial investment is usually €5,000 but can be higher for some bonds and some funds.

> Clients should be prepared to leave their funds invested in a unit linked investment bond for at least five years.

The lump sum is used to secure a number of units in the unit fund or funds chosen by the investor, based on the fund's unit price ruling on the day of investment.

8.1.1 Investment Term

Being Whole of Life policies, unit linked bonds do **not** have any fixed investment term. The client can hold onto the bond for as short or as long as period as they wish.

However, due to the impact of charges and the fluctuating value of unit fund prices, it is normally recommended that clients be prepared to leave their funds invested in a unit linked bond for at least five years.

8.1.2 Charges

A unit linked investment bond may have some or all of the following charges:

Investment bond charges

- Set up charge
- 1% insurance levy
- Allocation rate
- Annual fund charge
- Early encashment charge
- Administration charge
- Intermediary remuneration
- Bonus units
- Partial encashment charge
- Fund switching charge
- Investment transaction costs

Initial Monetary Set Up Charge

Some bonds may impose an initial monetary set up charge, for example, €500, which would be taken from the investment amount *before* the investment is used to buy units.

1% Insurance Premium Levy

1% is usually deducted from the initial investment amount to pay for the 1% insurance premium levy, *before* the investment is used to buy units.

Allocation Rate

The percentage of the investment amount, after deduction of the 1% insurance premium levy, used to buy units at the ruling unit price. Frequently this rate will vary by the size of the sum available for investment, for example:

Available for investment (after deducting % levy)	Allocation rate
Less than €100,000	100%
€100,000 to €299,000	101%
€300,000 +	102%

An allocation rate less than 100% is a charge equal to the difference between 100% and the allocation rate.

For example, an allocation rate of 98% means that 2% of the investment amount will be taken from the investment amount *before* the investment is used to buy units.

So, for example, if €50,000 is invested in a unit linked bond, €49,500 is available for investment after deduction of the 1% premium levy. Let's say the allocation rate is 98%, to that 98% x €49,500 = €48,510 will be used to buy units and the balance of €990 (2% x €49,500) will be taken by the life company as a charge.

An allocation rate of more than 100% can be a benefit to the investor as more than the investment amount is used to buy units. So, for example, if €50,000 (after deduction of the 1% premium levy) is invested at an allocation rate of 102%, 102% x €50,000 = €51,000 will be used to buy units. However, in this case there may be an early encashment charge if the investor encashes units in the early years which can have the effect of clawing back all or part of this additional 2% unit allocation (see **early encashment charge** later).

In some cases, the allocation rate is before deduction of the 1% premium levy so that the levy reduces the allocation rate by 1%, which is then applied to the full investment amount.

Annual Fund Charge

This is an annual charge taken within the life company's unit fund **before** the unit price is set. The published unit price therefore already allows for this charge. It is sometimes referred to as the fund **annual management charge (**AMC) or **annual fund charge** (AFC).

A typical fund charge might be 1% ~ 1.5% pa, but some charges are higher or lower than this depending on the fund in question.

The term **investment return** is often used to describe a unit fund's return *before* deducting the annual fund charge, while the term **unit growth** refers to the growth in unit prices, i.e., after the deduction of the annual fund charge.

So, for example:

- A fund has an annual fund charge of 1% pa;
- The fund earns an investment return over the year of 5%, before deducting the annual fund charge; therefore,
- The fund's unit growth over the year is (5% - 1%) = 4%.

Most life companies retain the right to increase the annual fund charge in the future.

Some bonds may undertake to reduce the fund charge by a specified amount, after the bond has been in force for a specified period, for example, after five years.

For example, a bond may have an annual fund charge of 1.5% pa, reducing after five years to 1.3% pa, say.

Investment Transaction Costs

Every time a fund buys or sells an investment it incurs costs, including stockbrokers' fees and stamp duty. These costs are deducted within the fund before the unit price is set and are therefore not visible to the investor. However, they may affect the performance of the underlying assets.

Intermediary Remuneration Charge

Where the unit linked bond provides initial commission to insurance intermediaries, the allocation rate is usually reduced by the level of initial commission taken by the intermediary.

Example #1

Investor wishes to invest €50,000 in a unit linked bond. The standard allocation rate for this amount is, say, 102.5%.

If the intermediary opts to take 2% initial commission, the allocation rate will be 100.5%. (102.5% less 2%).

Some life companies pay ongoing annual 'trail' or fund-based commission to intermediaries on unit linked bonds, as a percentage of the encashment value of the bond. Fund based commission is recovered by way of a corresponding regular unit cancellation (see explanation below) by the life company or, more commonly, by a corresponding increase in the annual fund charge. This would normally be agreed with the client in advance.

Example #2

A unit linked bond investing in a particular unit fund has a standard annual fund charge of 1% pa. If the life company pays a regular 0.5% pa trail commission to the ongoing insurance adviser, the total annual fund charge will become 1.5% pa.

Early Encashment Charge

Some unit linked bonds impose a reduction in the encashment value where units are encashed within an initial period after investment, for example, during the first five years. This is to ensure that any extra allocation or commission paid is clawed back if the client decides to encash within the specified period.

This charge frequently scales down over this period.

Example #3

A bond imposes an initial early encashment charge as follows:

Units encashed in year	Charge
1	5%
2	5%
3	3%
4	2%
5	1%

So, for example, if an investor has 2,300 unit in a unit fund and the investor decides to encash the units in year three of the bond, when the unit price is €1.87, the encashment value of the bond, before any tax deduction, at that time would be:

2,300 x €1.87 x 97% = €4,172.

The 3% taken from the encashment value is a charge.

Unit Cancellation

Some unit linked bonds may provide for an annual charge, say 1% pa, to be paid by **unit cancellation**, i.e., 1% of the total number of units then attaching to the bond are encashed by the life company each year, and the value retained by the life company.

Therefore, in this example, the client's unit holding would reduce by 1% pa.

Example #4

A client invests in a life assurance unit linked bond and 10,000 units in a unit fund are initially allocated to the bond. The bond provides for an annual administration charge of 1% pa, to be met by unit deduction at the end of each year. The client's unit holding would reduce as follows:

Year	Number of units at start of year	Admin charge units deducted	Number of units end of year
1	10,000	100	9,900
2	9,900	99	9,801
3	9,801	98	9,703
4	9,703	97	9,606
5	9,606	96	9,510
6	9,510	95	9,415

Bonus Units

Bonus units are units that may be added to the unit linked bond at some stage in the future, in certain circumstances. They act as an incentive to the investor to maintain their investment for a set period of years.

Example #5

A bond promises to add a bonus of 1% of the then unit holding after one year and another 1% of the then unit holding after five years.

Bonus units are used as a way of rebating or refunding part of the initial charges levied for investments which stay a certain minimum period with the life company. Any encashment of units before the bonus date loses out on this bonus.

Bonus units added in this way are also sometimes referred to as a *loyalty bonus*, i.e., the extra units are added to investors who are 'loyal' and leave their funds invested for a prolonged period.

Partial Encashment Charge

Some bonds may impose a monetary charge for processing a partial encashment, i.e., where the investor encashes some of his or her units, but not them all.

8.1.3 Unit Fund Choice

There will usually be a wide range of unit funds offered to the investor in a unit linked bond:

Managed funds	These funds invest in a mix of company shares (regularly referred to as equities), bonds, property and cash deposits. These funds are also sometimes referred to as 'managed' funds. Some life companies offer a range of managed funds with different levels of investment in equities and property, i.e., different level of risks. For example, a 'cautious' managed fund might have a maximum of 40% invested in equities and property, a 'balanced' managed fund might have a maximum of 60% invested in equities and property, while an 'adventurous' managed fund might have a maximum of 80% invested in equities and property.
Multi-Asset funds	These funds are similar to managed funds but invest in a wider range of asset types including absolute return, commodities, derivatives, infrastructure, currencies and private equity. Managed and multi-asset funds are the most popular choice for investors who want to take a mid-course between investment risk and return.
Funds which invest in one asset class	An equity fund which invests only in equities, a property fund which invests only in property, a bond fund which invests only in bonds, and a cash/deposit fund which invests only in deposits or very short-term financial instruments.

Specialist funds	Funds which invest in a limited or restricted range of assets. For example, an equity fund which invests in a particular industry, for example, green energy, ESG, technology, telecoms, banks, smaller companies, etc, or in a very limited number of the top companies in the world. Such specialist funds, being narrowly focused in what they invest in, are generally higher risk funds than managed/multi-asset funds which invest in a broad range of asset types.
Commodity funds	Funds which invest in one or more types of commodities such as gold, silver, or food.
Funds with different investment management styles	There are two main types of investment management styles: **Active**: where the investment manager uses their skills to attempt to outperform a particular market, which is then set as the 'benchmark'. For example, a fund investing in European equities and **actively** managed, will attempt to outperform an index of European equities. This is generally a more expensive style of fund management. **Passive***:* where the fund is structured to match the performance of a particular market. For example, a fund investing in European equities and **passively** managed, will seek to very closely match the return provided by an index of European equities. This type of fund management is cheaper than active management. Consensus investment management is another form of passive investment management, where the asset allocation is determined on a passive basis. The term consensus refers to matching the consensus investment asset allocations of competing similar actively managed funds. Consensus managed funds will therefore mirror the average asset allocation of similar competing active funds between equities, bonds, property and cash, and geographical allocation within these asset classes. A consensus managed fund will not therefore be a top performer, but will not be a bottom performer either, as its performance should mirror the overall average return.
Internal and external fund managers	All unit linked bonds offer a choice of different funds managed by a range of external (to the life company) fund managers, in addition to funds managed internally by the life company's own in-house investment team. The annual fund charge is dictated by the style of management that the external fund manager uses.

Life companies categorise each unit fund it offers to investors in terms of its likely risk and return profile.

For example, a life company might place a particular unit fund into one of seven categories, with one being the lowest risk and hence likely over the longer term to produce the lowest return, and seven the highest risk and hence likely over the longer term to produce the highest return:

Risk/return rating						
1	**2**	**3**	**4**	**5**	**6**	**7**
Lowest risk						**Highest** risk

A key part of recommending suitable investments to clients is to recommend funds appropriate to the level of investment risk the client is willing to accept considering their personal and financial circumstances, experience and goals.

In conjunction with the above conversation, there is risk profile software which can be used to ask the clients a number of questions about their attitude to risk etc, and using the answers provided to score the clients into one of the seven risk categories above, for example, a four.

Therefore, a client with a risk rating of four may not be offered funds with a risk rating of one or seven, and their core fund holding would likely be placed in funds with a risk rating of four.

8.1.4 Rebalancing

Some unit linked bonds offer the option of an automatic **rebalancing** facility. This facility is designed to ensure that where an investor opts initially to invest in a mix of unit funds, the percentage split of the value of their investment between these funds is automatically maintained at the initial percentage chosen. This is done by the life company **automatically** switching units at regular intervals to rebalance the fund split.

Without rebalancing, the percentage of the bond value invested in the different funds would move away from the initial choice, over time, due to differing fund performance.

Example

Musa invests €50,000 in a unit linked bond, and opts to invest this sum as follows:

- 50% in an equity fund.
- 25% in a bond fund.
- 25% in a cash fund.

If, over the first year, the equity fund unit price increased by 20%, the bond fund by 7% and the cash fund by 2%, the value of Musa's bond at end of the first year would be:

- €25,000 x 1.20 = €30,000 in the equity fund.
- €12,500 x 1.07 = €13,375 in the bond fund.
- €12,500 x 1.02 = €12,750 in the cash fund.

The total value of the bond at the end of the first year is €56,125.

So, at the end of the first year, the value of Musa's bond at that stage would now be split as follows:

- €30,000/€56,125 = 53.4% in the equity fund.
- €13,375/€56,125 = 23.8% in the bond fund.
- €12,750/€56,125 = 22.7% in the cash fund.

The split of Musa's bond value between the three funds has therefore drifted away from his initial choice (50%/25%/25%), due to differing fund performance.

In the example above, the rebalancing feature would periodically **automatically** switch some units from the equity fund to the bond and cash funds, so that after each such switch the then value of Musa's bond would revert to his initial 50%/25%/25% chosen split.

Fund	Initial fund split	Fund split, at the end of the first year…	
		…without rebalancing	…with rebalancing
Equity	50%	53.4%	50%
Bond	25%	23.8%	25%
Cash	25%	22.7%	25%
	100%	**100%**	**100%**

The benefit to the investor of using rebalancing is that the risk profile of the investment, in terms of asset allocation, is maintained at the initial level chosen and doesn't drift over time to a higher or lower risk profile, due to differing fund performance.

For example, a medium risk investment could, over time, silently turn into a high-risk investment through different parts of the portfolio providing different returns. Of course, the opposite could also happen; without rebalancing a medium risk investment could, over time, silently turn into a low-risk investment.

Rebalancing may be offered on a monthly or quarterly or annual basis.

8.1.5 Property Fund Restrictions

Life companies frequently impose certain restrictions on investing in or switching existing funds into property unit funds:

- Some property funds may be closed to new investments, from time to time.
- The life company may retain a right to delay encashments from or switches out of a property fund by up to six months, or even longer, where the fund is experiencing net cash outflows and therefore needs to sell properties to meet the cash demands of investors cashing in their investments. This is sometimes referred to as 'gating' the investors, i.e. locking the investors in.

8.1.6 Unit Pricing

In general, the unit price of a unit linked fund is calculated as:

$$\text{Net asset value of fund} / \text{Number of units allocated to the fund}$$

The **net asset value** of the unit fund will usually be calculated by reference to the market *buying* price of the fund's assets on that day plus the estimated acquisition costs (for example, stamp duty, etc); in effect, the investor buying units has to pay the buying price of the underlying assets of the fund.

Example

Buying price of fund's assets	€25,000,000
Add on estimated acquisition costs (2%)	€500,000
Total	€25,500,000
Less loans, debts etc, owed by the fund	Nil
Number of units	20,000,000
Unit price	€25,500,000/20,000,000 = €1.275

A life company will usually adopt the approach above where the fund is experiencing net cash inflows, i.e., more new investments are coming into the fund than are going out in encashments.

However, if a fund is experiencing cash outflows, i.e., more money is going out of the fund than is coming in by way of new investments, the life company may switch to setting the unit price by reference to the *selling* price of the fund's assets on that day less the estimated costs of disposal costs:

Disposal value of fund's assets	€20,000,000
less disposal costs (2%)	€400,000
Total	€19,600,000
Less loans, debts etc, owed by the fund	Nil
Number of units	20,000,000
Unit price	€19,600,000/20,000,000 = €0.98

If a life company experiences strong outflows from a fund it may switch to setting unit prices from the buying value of the assets to the selling value in order to protect the remaining investors. If it lets encashing investors out at too high a unit price, the remaining investors will bear the loss unfairly.

In the case of property funds, in particular, the unit price can fall sharply if the fund goes into net outflows and the life company switches to valuing properties on estimated selling price less disposal expenses.

8.1.7 Death Benefit

Unit linked investment bonds typically provide a death benefit slightly higher than the encashment value of the bond at the date of death, such as 101% of encashment value of units on death.

Most bonds do not impose the early encashment charge on death, within the early encashment charge period.

Example

Joe invests €50,000 in a unit linked bond with Acme Life Co. The bond has an early encashment charge of 5% in year one reducing to 1% in year five. The death benefit is 101% of the value of units at the date of death.

Joe dies during the fourth year of the bond, when the bond has 19,104 units. At the time of death, the unit price is €3.20. The normal encashment value of the bond at that time would be:

19,104 x €3.20 x 98% = €59,910 (before tax is deducted).

As a death benefit, the benefit payable would be:

19,104 x €3.20 x 101% = €61,744 (before tax is deducted).

Where two people invest jointly in a unit linked investment bond, the policy is usually arranged on a *joint life last survivor basis*, i.e., no death benefit is payable on the first to die; rather ownership of the bond passes automatically to the survivor. The death benefit is only payable when both have died.

In the case of a unit linked bond taken out by one individual, the bond pays out on his or her death.

8.1.8 Investment Risk

Most investors look on investment risk as the risk that they will get back less than they invested and so suffer a *permanent* loss of capital. This could happen where they invest in a unit fund or funds and encash their units (or switch out of the units to more secure funds) at a time when the relevant unit prices are lower than the unit price at which they bought the units.

Investors can usually opt to invest their contributions in a mix of different unit funds, for example, 50% in a multi-asset fund and 50% in a particular equity fund.

There are several different types of risks which can give rise to a fall in unit prices of a particular unit fund over a particular period of time:

Market Risk

This is the risk of being invested in a particular investment market, such as bonds, shares, and/or property, at a particular time, when that market is generally falling in value and a client requires their fund at or near the bottom.

One method of attempting to reduce market risk is through diversification between the main asset classes, for example, equities, bonds, property and alternatives, in the hope that returns from these different types of assets are not highly correlated (i.e. not likely to move together in step), so that if one asset class is going down another might be going up.

Currency Risk

Funds which invest directly or indirectly in assets outside the euro area involves an additional *currency risk*, i.e., the risk that the currency in which the asset is denominated will fall in value against the euro, even if the assets themselves don't fall in value.

For example, if the US stock market provided a return of 6% over a year, but the US dollar fell in value by 8% against the euro over that year, a euro investor in the US stock market would have achieved a -2% (6% – 8%) return over that year, even though the US stock market provided a US dollar return of 6% over the year.

Of course, the opposite could happen; the US dollar could have increased in value against the euro during the year, say by 8%, so that a euro investor would have received a return of 8% + 6%, i.e., 14% for the year.

Gearing Risk

Some funds, for example, typically property funds, may borrow to invest, which is sometimes referred to as *gearing*. The investor is exposed to higher risk where the fund contains borrowing; the higher the level of borrowing, the higher potential investment gains and losses become.

This Table shows the fall in the value of an investor's capital in a fund, at different borrowing levels and for different falls in the underlying fund asset value:

Fall in value of investor's capital

Fall in asset value	Borrowing level			
	None	1:1	2:1	3:1
5%	5%	10%	15%	20%
10%	10%	20%	30%	40%
15%	15%	30%	45%	60%
20%	20%	40%	60%	80%
25%	25%	50%	75%	100%

So, for example:

- An investor would suffer a 60% fall in the value of their investment in a fund which borrows three times the amount invested in the fund (3:1 above) if the value of the fund's assets fell by 15%.
- But if the borrowing level in the fund was one times the amount invested in the fund (1:1 above), a 15% fall in asset values would reduce the value of the investor's capital in the fund by 30%.

Of course, gearing can work the other way as well. An investor would benefit from a 60% increase in the value of their investment in a fund which borrows three times the amount invested in the fund (3:1) if the value of the fund's assets increased by 15%.

Gearing or borrowing in an investment fund therefore magnifies the positive and negative returns from what the fund invests in.

Liquidity Risk

Some funds may invest in assets which may not be capable of being sold quickly at a fair price, in the event of a sudden market downturn.

For example, a fund which invests in large commercial properties like office blocks, etc, may not at certain times be able to see its assets to raise cash to allow investors to leave the fund, other than at a sharp discount to its asset value.

So, such funds can experience sharp drops in value if a significant number of investors all want to 'head for the exit' at the same time, and the fund may have to delay encashments until it can raise sufficient cash by selling assets.

Interest Rate Risk

Interest rate risk is the risk that a future change in interest rates may adversely affect the value of the unit fund's assets and hence the investment return produced by the fund.

For example, a general rise in interest rates will likely result in a fall in the market value of certain investments, such as bonds. In general, longer dated bonds are likely to fall proportionately more in value than shorter dated bonds, if interest rates rise.

Therefore, while longer dated bonds will generally offer higher returns than shorter dated bonds, the investor in a fund which invests in longer dated bonds is taking an increased interest rate risk, as well as an increased inflation risk.

A significant general rise in interest rates is also likely to result in a fall in property values.

Active Investment Manager Risk

Some unit linked funds are actively managed by a professional investment manager, to try and produce a return higher than the market.

There is a very high risk that the manager of such a fund will get some investment decisions wrong and hence produce a return lower than the fund's benchmark return.

Sector or Country Risk

Exposure to one country or indeed sector carries risk in and itself. But it can easily happen as clients may have biases based on where they work and live. For example, to have been invested solely in Irish Banks in 2008 would have resulted in poor returns. The way to mitigate this risk is to be globally and sectorally diversified.

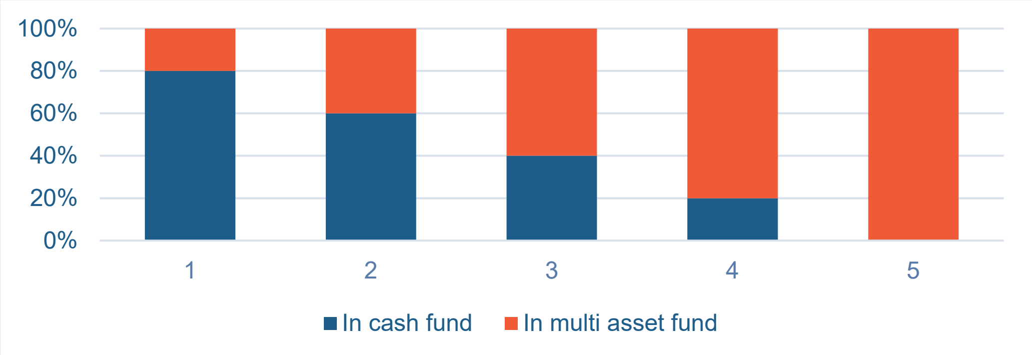
8.1.9 Drip-Feeding

Some unit linked bonds offer investors an option to initially invest predominately in a low-risk cash fund and then drip-feed the investment in instalments over a period of time into the chosen higher risk fund or funds, for example, a multi-asset fund.

Example

Mary invests €50,000 in a unit linked bond. Her chosen fund is the life company's multi-asset fund. She opts for the drip-feeding option over five months, and hence her bond will be invested as follows, over the first five months:

Month	In cash fund	In multi-asset fund
1	80%	20%
2	60%	40%
3	40%	60%
4	20%	80%
5	Nil	100%



The drip-feeding facility is designed to give the investor some comfort that they aren't buying in at what they may perceive to be the top of the market.

Take for example, this pattern of monthly unit prices for a higher risk fund the investor wishes to invest in long term:

If the investor invests all his or her investment in the fund at month one-unit prices, they are then fully exposed to the fall in unit prices from month one to three.

Drip feeding attempts to protect the lump sum investor from potentially investing all of his or her investment at what they perceive to be a high point in investment markets.

However, the downside is that it also prevents the consumer from investing all of his or her investment at what turns out to have been a low point in the investment markets.

Drip feeding is therefore not a guaranteed benefit to the investor; in falling markets it can protect the investor to some extent, but in rising markets it can reduce the return to the investor as the full investment does not benefit from rising markets.

Assuming any funds being invested are with the long term in mind there is significant evidence to suggest that drip feeding funds into the market has nothing more than a psychological benefit to clients as it is not possible to attempt to time markets successfully as a strategy.

8.1.10 Fund Switching

Investors can change their unit fund choice at any time if they wish. **Switching** refers to exchanging units of one-unit fund for units of equivalent value in another unit fund.

Example

An investor has, say, accumulated 21,452.23 units in a Managed Fund, which has a current unit price of €2.45. The investor is concerned about short term volatility in equity markets and decides to switch his Managed Fund holding to the more secure Cash Fund, which has a current unit price of €1.45.

If no charge is made on the switch, the units are exchanged on the basis of equivalent value, so that just after the switch, the bond is worth exactly the amount as it was before the switch:

21,452.23 units in the Managed Fund has a current value of:

21,452.23 x €2.45 = **€52,558**.

€52,558 would secure:

€52,558 / €1.45, i.e., 36,246.90 units in the Cash Fund, with a value of:

36,246.90 x €1.45 = **€52,558**.

Some life companies allow investors to make a number of free switches each year, but may impose a small administration charge, say €50, for subsequent charges. This charge, when levied, is usually paid for by way of encashment of units, i.e., life company would encash units and deduct these units from the investor's unit holding.

8.1.11 Encashment Value

The encashment value, before any tax deduction, at any time of a unit linked bond is usually calculated as:

Number of units x unit price at encashment date

However, where the bond is encashed within the first five years or so of investment, the encashment value may be reduced by a charge, called an early encashment charge (see Chapter 8.1.2 earlier).

8.1.12 Partial Encashment

Most unit linked bonds offer the investor the option to take a **partial encashment**, i.e., surrender of *part* of their unit holding, and leave the balance invested in the bond.

Any early encashment charges would only then be applied to the unit holding actually encashed. The bond then continues on with the remaining balance of units.

Example

Luiz has 12,903 units in Fund A with a particular life company. The bond levies an early encashment charge of 5% in year one, reducing by 1% each year to zero from year six onwards.

In year two, Luiz decides to encash 500 units, at the then ruling unit price of €2.56.

The encashment value, before tax is deducted, of the units being encashed would be:

500 x €2.56 x 96% = €1,228.80.

Luiz retains the remaining 12,403 units which he encashes in year five, when the unit price is €3.56. The final encashment value, before tax is deducted, would be:

12,403 x €3.56 x 99% = €43,713.

Life companies usually impose a minimum partial encashment amount, for example, €500, and subject to a minimum remaining value of the bond of, say, €5,000.

8.1.13 Regular Encashment Facility

Normally partial encashments are once off encashments taken at the initiative of the policyholder.

Some unit linked bonds offer a facility for the investor to opt to take *regular*, for example, monthly or quarterly, partial encashments, which are made **automatically** by the life company on the investor's instructions and the payments (less any tax deducted) sent automatically to the investor's bank account.

This facility is referred to as **regular encashments** or **automatic income** facility.

Different regular encashment options are sometimes offered to the policyholder:

- A specified % of the then unit holding, for example, the investor can specify a rate of 5% pa of the unit holding. This percentage of units would then be encashed each year and the proceeds paid to the investor, less tax if appropriate.

- A specified monetary amount, before tax, for example, €500 every six months or, say, 5% pa of the initial investment, before tax, would be funded by automatic encashment of sufficient units. The tax, if applicable, would be deducted and the net amount paid to the investor.

Frequently, the life company may impose a maximum rate of regular withdrawal, for example, 8% pa, so that investors do not risk running down their investment too quickly.

However, there are two important points to be remembered about the regular or automatic income facility:

- Despite sometimes being called automatic *income* payments, the payments are **not** in fact '*income'* from the unit fund's investments but rather a partial encashment of the client's total unit holding.

- The payments are **not** *income* for income tax purposes in the hands of the investor, but a partial encashment of the individual's life assurance policy.

The value of the bond will therefore fall immediately after each partial encashment.

Exit tax (see following section) will be deducted from any gain realised on a full or partial encashment. Once exit tax is deducted, the investor has no further tax liability on returns.

The term automatic **income** is potentially misleading, as the client could infer from the *income* reference that all he or she is taking from the bond is the *income* accruing to the fund and that his or her capital invested is still intact. This is not the case.

In extreme cases, there is a danger that the cash value of the bond could run out completely, due to a combination of too high a rate of drawdown and too low an investment return achieved.

8.1.14 Exit Tax

For unit linked bonds and unit linked savings policies:

- Unit funds earn tax-free investment returns.
- On unit encashment, any gain realised over and above the amount invested is subject to an **exit tax** deduction, currently at:
  - 25% where the policyholder is a company.
  - 41% in all other cases.

  The term **exit** refers to the fact that the tax is not generally payable until funds are *exiting* or leaving the policy, i.e., on encashment of units or death benefit pay-out.

  Where the pay-out arises on death, the gain is calculated as if the bond was encashed the day before the death occurred. The intention here is to exclude from exit tax any benefit which is payable only on death, i.e., life assurance cover (see Example #2 below).

  Once exit tax, if applicable, is deducted from the pay-out, the investor has no further personal tax liability on returns.
- If a bond is encashed at a loss, no exit tax is due. Such a loss cannot be offset or carried forward to be used against any other gain for tax purposes.

Example #1: Full Encashment

Mary invests €10,000 in a unit linked bond.

Six years later, she fully encashes the bond for €15,000. She has not previously made any partial encashment from the bond.

The gain, liable to exit tax of 41%, is:

€15,000 - €10,000 = €5,000.

Exit tax deducted by life company is:

41% x €5,000 = €2,050.

Paid out:

€15,000 - €2,050= €12,950.

In the following example below, the pay-out is on death. The gain is calculated as if the bond has been encashed the day *before* death.

Example #2: Death

Mary invests €10,000 in a unit linked bond.

Seven years later she dies when the cash value of the bond is €15,000. The death benefit is 101% x cash value of bond. She had not taken any prior encashment from the bond.

For exit tax purposes, the bond is treated as having been encashed the day <u>before</u> Mary died.

So, the gain, liable to exit tax of 41%, is:

€15,000 - €10,000 = €5,000.

Exit tax deducted by life company is:

41% x €5,000 = €2,050.

Paid out to Mary's estate:

€15,000 x 101% - €2,050 = €13,100.

The extra benefit which is payable <u>only</u> on death, i.e., life assurance cover of 1% x bond value, is not subject to exit tax. Therefore, the extra 1% is not considered in working out the exit tax to be deducted.

In the case of a partial encashment from a unit linked bond, i.e., where an investor encashes some but not all of their unit holding, the gain is calculated allowing a proportion of the original investment to be offset against the gain, if any, for exit tax purposes; the proportion being:

[Partial encashment /Value of bond *before* encashment]

Example #3: Partial Encashment

Mary invests €10,000 in a unit linked bond.

Seven years later when the bond is worth €15,000, she takes a partial encashment of €2,500, before tax. She has not previously taken any encashment from the bond.

In working out the gain on the partial encashment, only part of the original investment is allowed as a deduction, the part being calculated as:

[Partial encashment value/Value of bond before partial encashment].

The gain on this partial encashment is therefore calculated as:

€2,500 – €10,000 x [€2,500/€15,000] = €2,500 – €1,667 = €833.

In effect €1,667 of the original capital invested of €10,000 is being encashed with a gain of €833. As this is deemed to be part of the original capital invested, it is not liable to exit tax and hence only the part of the partial encashment above €1,667 in this example, i.e., €833, is liable to exit tax.

Exit tax of 41% x €833 is therefore deducted, i.e., €341 from the partial encashment and so €2,500 – €341 = €2,159 is paid out to Mary as a partial encashment.

Where a unit linked bond or savings plan is in force 8 years, a **deemed encashment** is applied to the policy on the 8th anniversary and any gain deemed to arise at that time is subject to exit tax, with the exit tax then being withdrawn from the policy. The policy continues.

Example #4: Deemed Encashment after 8 Years

Mary invested €10,000 in a unit linked bond 8 years ago.

She has not taken any encashment from the bond to date.

On the bond's 8th anniversary its encashment cash value is €18,000.

The bond is *deemed* to be *encashed* for exit tax purposes, and so the gain liable to exit tax of 41%, is:

€18,000 – €10,000 = €8,000.

The life company will therefore deduct €8,000 x 41%, i.e., €3,280 from the bond, by encashment of units, and pay it the €3,280 over to Revenue.

The bond continues on with a reduced unit holding valued at €14,720

Some investors can be **exempt** from the exit tax, subject to completion of a Declaration to the life company:

- Non-residents.
- Charities.
- The Courts Service, who invest funds paid into court for minors and individuals who are permanently incapacitated.
- Credit Unions.
- Personal retirement savings accounts (PRSAs).
- Pension schemes.
- Approved retirement funds (ARFs).

Other investors can **reclaim** exit tax deducted by the life company:

- Individuals who are permanently and totally incapacitated as a result of personal injury.
- Trusts set up by public subscriptions for the benefit of individuals who are permanently and totally incapacitated can reclaim the exit tax arising from the investment of the trust funds, provided the income from the trust or the investment returns from the investment of the trust funds is the sole or main income of the individual.
- Individuals who received compensation awards for thalidomide children can reclaim the exit tax arising from the investment of such awards.

In each case above where the exit tax is reclaimable from Revenue, the life company MUST deduct the exit tax in the normal manner, but the policyholder can then reclaim the tax from Revenue in their tax returns.

Where a partial or total encashment gives rise to no gain, then no exit tax is payable, and the full encashment amount is paid out to the investor.

8.1.15 Benefits

The main benefits of unit linked investment bonds to investors are:

- Investment can be made in a wide range of professionally managed investment funds with different risk/return characteristics, which accumulate tax free subject to exit tax being deducted from any gain paid out to the investor and on each 8th anniversary.
- Ready access to funds. Part or all of the units can usually be encashed at any time, but some funds investing in illiquid assets such as property may retain the right to delay encashments.
- Regular encashments can be taken, subject to certain restrictions.
- Open ended investment term.
- Simplified administration: the investor avoids having to make annual income and capital gains tax returns to Revenue which would apply if investing directly in stocks and shares.

8.1.16 Limitations

Unit linked investment bonds may be subject to certain limitations or restrictions:

- A minimum investment of €5,000 typically. Partial encashments may be subject to a certain minimum remaining value in the bond.
- To avoid potential early encashment charges and to benefit from fluctuating investment markets, the investment should be maintained for a certain minimum period, typically five years. Such bonds are therefore not suitable for short-term investment.
- Restrictions may be placed periodically on switches into and out of, and encashment of certain funds, for example, property funds.
- For some investors, particularly those who are non-or-low-rate taxpayers, unit linked bonds may not be tax efficient compared with direct investment because:
    - An exit tax rate of 41% applies compared with a capital gains tax rate of 33% which applies to grains realised on direct investment.
    - An inability to reclaim exit tax deducted even if otherwise a non-taxpayer.
- Any investment losses suffered on a unit linked bond cannot be offset for tax purposes against a gain realised on other investments.

8.1.17 Risks

The main investment risks associated with unit linked investment bonds are:

- The investor could get back less than the investment amount if encashed early and/or the unit fund or funds to which the plan is linked performs poorly.
- The investment risk will vary significantly by the risk profile of the unit fund or funds.
- The investor's investment may reduce in real value terms if the return achieved is less than the rate of inflation over the period of investment.

- The investor could get back less than the anticipated or projected return if the unit fund or funds to which the plan is linked produces a lower investment return than anticipated or projected at the outset.

- Investors taking automatic income or regular encashments from their bond could run down their investment if they take too high a rate of withdrawal and/or the unit fund or funds to which the plan is linked provides a lower rate of investment return.

8.1.18 Comparing Unit Linked Bonds

In determining the suitability of different unit linked investment bonds to meet the consumer's investment needs, the following features should be identified and compared:

Minimum investment	Fund & risk choice	Charges	Access	Financial strength

Minimum Investment

What is the minimum investment under each of the bonds? This will be relevant if some have a minimum investment requirement higher than the sum the investor has available for investment.

Fund & Risk Choice

What fund or funds are offered by each bond and how are these funds classified by the life company for risk purposes? Some may have a narrow range of funds, while others may have a wider range of funds, with different risk profiles, which may offer a better match to the client's attitude to and capacity for investment risk.

A bond should ideally have at least one secure fund option, to which the investor can switch in times of turbulent investment markets.

Are there any restrictions on investing in or switching out of or encashing units of certain funds?

What are the investment objectives/management styles of the different funds offered?

Charges

What charges will apply to each bond; at the level of investment the consumer will make:

- Initial charges, for example, allocation rates.

- Recurring charges, for example, annual fund charges.

- Early encashment/termination charges.

- Other charges, for example, partial encashment, fund switching, etc.

Do charges vary by the size of the investment, and/or by the length of time the bond is held, or in any other way?

One way of comparing the impact of charges is to look at the respective projected **reduction in yield** (RIY)[7], on similar investment return assumptions for the same investment and investment term.

[7] *See Chapter 13.4.*

Access

What access is there to part or all of the investment? Do any potential penalties or charges apply on part or total encashment?

How often does the fund trade?

Does the bond provide a regular encashment facility? If so, what are the restrictions?

Financial Strength

Does the life company have a financial strength rating from a ratings agency? Is the life company part of a larger international financial services group?

8.2 Tracker Bonds

Life assurance companies may also offer investment bonds, often referred to as Tracker Bonds, which aim to participate in the capital return from certain risk assets, usually with the benefit of some level of capital guarantee on maturity. These types of bonds can also be offered by banks as a form of fixed term deposit (deposit Tracker Bonds are covered in the Investment module).

Tracker Bonds are fixed term investments, with a term typically between three to six years.

Such investments are sometimes referred to as Structured Bonds.

8.2.1 Two Components

Typically, a life assurance Tracker Bond offers two benefits to the investor:

- A guaranteed return on maturity of the bond at the end of a fixed term, of a specified proportion (usually between 80% to 100%) of the original capital sum invested.

  PLUS

- A possible bonus payable at the end of the fixed term, usually related to a percentage (referred to as the **participation rate**) of the rise, if any, in some specified index of investment asset values.

Sometimes the bonus is limited or capped at a maximum figure.

Exit tax is applied to any amount payable at maturity over and above the repayment of the capital sum invested. Of course, if the chosen index of investment asset values does not rise over the period, there may be no bonus payable on maturity. But the capital guarantee would continue to apply.

Example #1

A Tracker Bond has a term of 6 years, and it offers at maturity:

- A capital guarantee of 90% of the capital invested, payable at the end of the 6-year term.

  AND

- A bonus of 60% of the rise in the S&P 500 US stock market index over the period, to a maximum of 34%.

At the end of the 6-year term, let's assume that the index has risen over the period by 50%.

An investor who invested €100,000 would get back at the end of the 6-year term:

- €90,000 capital, i.e., the 90% capital guarantee.

  AND

- A bonus of 60% of the 50% rise in the index i.e. 30% of €100,000, i.e., €30,000 gross, giving a total value on maturity, before exit tax, of €90,000 + €30,000 = €120,000.

Exit tax is only levied on the gain over the investment amount, i.e. on €20,000 in this case, so that the payout to the investor in this case would be:

€120,000 less 41% x €20,000 = €111,800.

Example #2

A Tracker Bond has a term of 6 years, and it offers at maturity:

- A capital guarantee of 90% of the capital invested, payable at the end of the 6-year term.

  AND

- A bonus of 60% of the rise in the S&P 500 US stock market index over the period, to a maximum of 34%.

At the end of the 6-year term, let's assume that the index has fallen over the period by 25%.

An investor who invested €100,000 would get back at the end of the 6-year term:

- €90,000 capital, i.e., the 90% capital guarantee.

  AND

- No bonus, as the index did not grow in value.

The investor therefore, in this example, gets back a total of €90,000 at the end of the 6-year term, with no exit tax because the investment did not produce any gain.

The terms of each Tracker Bond will vary. There is usually a trade-off between the extent of the capital guarantee given, the investment term, and the maximum potential bonus. Some life companies may offer a range of options with regard to these features.

For example, a Tracker Bond might offer these options:

Option	Investment term	Capital guarantee	Participation rate	Maximum bonus
1	5 years	90%	40%	25%
2	6 years	100%	75%	80%

Increasingly, more and more complicated formulae linked to more obscure investment asset values are used in Tracker Bonds to determine the bonus payable.

Some bonds may headline what may seem to be very attractive participation rates and maximum bonus rates. However, in some case the bonuses referred to are highly conditional; for example, a bonus may be payable if, say, all 30 shares in a specified basket of shares increase in value by at least a specified percentage, and, if even just one share fails to make the threshold growth rate required, no bonus or a substantially reduced bonus is payable.

Traditionally Tracker Bonds had fixed **participation rates**, i.e., the percentage of the rise in the relevant index or indices payable as a bonus (usually subject to a maximum rise) is fixed at the outset and cannot change.

8.2.2 Averaging

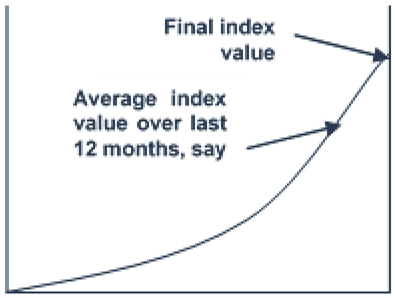
One risk for investors in some Tracker Bonds is that the index which determines the bonus may fall sharply just before the bond is due to mature on a particular day, and hence drag down the bonus payable or even lead to no bonus payable.

To counteract this risk, some Tracker Bonds take an average value of the index, over a specified period before maturity of the bonds, for example, over last six or 12 months.

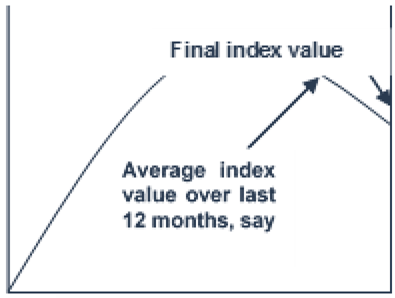
This can work out to the investor's benefit if the index falls sharply in value just before the bond matures as, in that case, the higher *average* index value would be used, rather than the lower index value on the day of maturity.

Of course, averaging of the closing index value can also work against the investor. If the index in question is rising sharply coming up to the maturity of the bond, in that case the lower *average* index value would be used, rather than the higher index value on the day of maturity.

For the purpose of calculating the change in an index over the investment term to determine the bonus payable, the index at the end of the Tracker Bond term may sometimes be specified as the averaged value over a period of time, for example, over the last 12 months prior to maturity.



Index rising up to maturity



Index falling up to maturity

8.2.3 Structure

The investment made by the investor in a life assurance Tracker Bond is split into three components:

- **Most is invested by the life company to provide the capital guarantee at maturity of the bond**. The life company will determine this amount by reference to market interest rate levels for the term of the bond, applying at the time the bond is issued.

  This table shows how much needs to be invested to provide €1,000 at the end of the bond term, assuming different interest rates:

Term (years)	0% pa	1% pa	2% pa
2	€1,000	€980	€961
3	€1,000	€971	€942
4	€1,000	€961	€924
5	€1,000	€951	€906

  The shorter the term and/or the lower the interest rate, then more of the investment amount needs to be invested to secure the capital guarantee, thereby leaving less to provide the bonus.

  Conversely, the longer the term and/or the higher the interest rate, then less of the investment amount needs to be invested to secure the capital guarantee, thereby leaving more to provide the bonus.

  In most cases, the life company will secure the guarantee by investing the funds with another financial institution like a bank, who in effect then provide the guarantee to the investor, i.e., if the bank fails to repay the full guaranteed amount to the life company, the life company are not liable to make up the difference to the investor. This risk for the investor is referred to as the **counterparty risk.**

- **Part is used by the life company to purchase an option or derivative** from a large international investment bank or investment manager, who in return undertakes to pay the bonus, if any, to the life company at the end of the bond term. The actual cost will vary from time to time and according to the nature of the bonus, i.e., what index or indices it is linked to, the participation rate, the maximum bonus payable, the term of investment, etc.

  Most Tracker Bonds provide that if the provider of this bonus to the life company defaults on payment of the bonus to the life company, then the bonus is not payable to the investor by the life company and hence the investor would not get the bonus. The investor may therefore run a **counterparty risk** in relation to both the capital guarantee **and** bonus.

- **The balance is taken in charges**.

For example, one specific Tracker Bond showed the following split of a €10,000 investment:

€9,387	(**93.87%**) Used to secure the promised payment of €10,000 payable at maturity after 6 years. This is equivalent to a promised return on this part of the investment of 1.0% pa, before exit tax is deducted.
€291	(**2.91%**) Used to secure the cash bonus payable at maturity through the purchase of a derivative or through a swap arrangement.
€322	(**3.2%**) Taken in charges, including intermediary remuneration.
€10,000	

Tracker Bonds are essentially fixed interest term investments as, usually, more than 90% of the investment amount earns a fixed return for the term of the bond, with typically circa 5% of the investment amount being used to secure the bonus payable at maturity, linked to stock market returns.

8.2.4 Access

Tracker Bonds are usually described as **illiquid** investments; usually there is no facility for the investor to encash the bond before the maturity date. Therefore, funds are tied up for the term of the bond.

They are therefore unsuitable for investors who may or are likely to require access to part or all of their investment before bond's maturity date.

8.2.5 Death

Tracker Bonds may provide no death benefit or provide a limited death benefit. The deceased's estate may have to wait until the bond matures to get access to the funds.

8.2.6 Exit Tax

Exit tax is deducted from any gain arising at maturity of the bond, over and above the amount invested in the bond.

If the bond provides only a return of the original capital invested or a sum less than the original capital investment, there is no exit tax deducted at maturity as there is no gain.

8.2.7 Benefits

Tracker Bonds provide investors with an opportunity to participate in returns from potentially high risk/high return assets such as equities, with reduced risk to their capital, provided they are prepared to tie up their investment for the full term of the bond.

8.2.8 Limitations

The limitations on investing in a Tracker Bond include:

- There may be a minimum investment, for example, €20,000 or upwards.
- The investment does not provide any income during the term.
- The investment must be maintained for the full term, in order to obtain the full guarantee and possible bonus promised.

- Typically, a significant proportion of the investment is invested in a fixed return investment with typically as little as 5% invested to secure the bonus return when fees and charges are taken off. Participation in risk asset returns can therefore be limited and in some cases the index or fund(s) to which the bonus is linked can be of questionable value.

- Investors do not typically benefit from dividend/income returns of the shares or securities to which the bonus is linked; typically, the bonus is linked only to the movement in the *capital* value of the assets involved, over the term of the bond.

- Generally, no or limited access to the investment during the term of the bond.

8.2.9 Risks

The main risks for a client of investing in Tracker Bonds are:

- The investor might need access to their funds before the bond matures; the investor may have no access to their funds at all, or if early encashment is allowed it will incur substantial penalties and lead to a significant loss to the investor.

- The investor may get back less than the amount invested, where the bond does not provide a minimum guarantee at maturity of at least 100% of the investment amount.

- The investor may only get back the guaranteed minimum amount under the bond, i.e., that the ‘bonus’ element payable may be nil because the relevant asset values to which the bonus was linked does not increase in value sufficiently to give rise to a bonus payment.

- The exit tax rate applicable at maturity to any gain realised could increase from the level applying at the time of investment, and so the investor could get a lower net return than anticipated (of course, the rate could also fall over the period).

- The investor may be exposed to *counterparty risk* in relation to the capital guarantee and/or bonus payment, where a third party is providing these benefits to the life company.

- The real value of the investment will reduce if the return provided by the bond at maturity is less than the rate of inflation over the investment term; this is particularly likely to happen where the investor gets back only the guaranteed minimum amount under the bond.

8.2.10 Comparing Tracker Bonds

In determining the suitability of different Tracker Bonds issued by life assurance companies to meet the client’s investment needs, the following features should be identified and compared:

Minimum investmemt	Term	Capital guarantee	Participation
Charges	Access	Counterparty risks	Financial strength

Minimum Investment

What is the minimum investment under each of the bonds? This will be relevant if some bonds have a minimum investment requirement higher than the sum the investor has available for investment.

Investment Term

What is the investment term of each bond, i.e., the duration at which the capital guarantee is payable together with the bonus?

Capital Guarantee

What level of capital guarantee is provided by each bond, and who is providing this guarantee?

Where the guarantee is not provided by the life company issuing the bond, does the counterparty risk related to the guarantee pass to the investor and if so, what is the financial standing of the provider of the capital guarantee?

What AER[8] is provided by the part of the investment used to secure the capital guarantee?

Participation Rate

What is the bonus provided by each bond and how is it calculated? Who is providing this bonus? Where the bonus is not provided by the life company, does the counterparty risk related to the bonus pass to the investor and if so, what is the financial standing of the provider of the bonus?

How much of the investment will be absorbed in providing the bonus? Generally, the higher this %, the better chance there is of getting a return over and above the guaranteed capital return.

Charges

What proportion of the sum invested will be absorbed by charges? The lower, the better.

Access

What access is there to part or all of the investment? Do any potential penalties or charges apply on part or total encashment?

Counterparty Risks

Who is providing the capital guarantee and the bonus, if not the life company itself?

Financial Strength

Does the issuer of the bond and any counterparties have a financial strength rating from a ratings agency? Is the issuer or counterparty part of a larger international financial services group?

[8] *Annual Equivalent Return. See Chapter 13.*

Review

Now consider the main teaching points, which were introduced in this Chapter. They are listed below. Tick each one as you go through them.

- [ ] The main features, benefits, limitations, and investment risks of unit linked investment bonds
- [ ] The main features, benefits, limitations, and investment risks of life assurance Tracker Bonds
- [ ] Comparing Investment and Tracker Bonds

Sample Questions

The answers to these questions can be found in your Study Hub.

1. If a unit linked fund aims to outperform a particular stock market index, it is said to be adopting which investment management style?

   A. Active.
   B. Tracker.
   C. Passive.
   D. Consensus.

2. A life company may, from time to time, refuse to accept new investments into which one of the following types of unit funds?

   A. Property.
   B. Equity.
   C. Bond.
   D. Managed.

3. If John invests all of his monies into Irish bank shares what type of risk is he exposed to?

   (i) Currency.
   (ii) Sector.
   (iii) Inflation.

   A. (i) only.
   B. (ii) only.
   C. (i) and (iii) only.
   D. (i), (ii) and (iii).

4. Ciaran has invested €50,000 in a life assurance tracker bond. It provides a guarantee at maturity of 90% of the sum invested, plus 70% of the rise, if any, in the FTSE 100 Index over the period of the investment. If the Index rose by 50% over the period of the investment, what is the maturity value of the bond, before deduction of any exit tax?

   A. €62,500
   B. €67,500
   C. €70,000
   D. €80,000

09

Savings Plans

This Chapter covers how unit linked savings plans work, their benefits, limitations, and risks. The Chapter also examines how to compare savings policies and how to assess a client's savings need.

Learning Outcomes – after studying this chapter you should be able to:
explain how unit linked savings plans work, including: - their purpose and design. - charging structures. - projected breakeven point. - taxation treatment.
assess and quantify a client's savings need.
set out the benefits, limitations and risks associated with unit linked savings plans.
explain the various headings under which savings plans can be compared.

Chapter weightings	Number of questions which may appear		
In the exam, questions are taken from each Chapter based on the following approximate chart:	Chapter	Minimum	Maximum
	9	6	8

9.1 Unit Linked Savings Plans

A **unit linked savings plan** is a life assurance policy into which the saver pays a regular contribution, usually monthly, to purchases units in one or more unit linked funds operated by the life company. The purpose of the plan is to accumulate a capital sum over time from regular savings.

> The purpose of a savings plan is to accumulate a capital sum over time from surplus income.

The value of the plan at any time is the encashment value of the units then allocated to the plan at that time.

The policyholder may encash the plan at any time for its then encashment cash value, less any exit tax due, to provide a capital sum to meet some financial need; however, a minimum savings term of 10 years is usually recommended in order to benefit from investment market cycles and lower charges.

Unit linked savings plans are therefore generally not suitable for very short-term savings needs.

If the policyholder dies before encashing the plan, the plan usually pays out the then encashment value, subject in some cases to a minimum monetary pay-out.

9.1.1 Allocating Units

As each regular contribution is paid into the plan, it (after deduction of the 1% insurance premium levy) notionally purchases units in one or more of the life company's unit funds at the ruling unit price. Units can be encashed at the unit price at the date of encashment.

Take, for example, this possible pattern of notional unit purchases where the client is saving €100 pm, or €99 pm *after* deduction of the 1% premium levy:

Month	(1) Contribution paid (after 1% levy)	(2) Unit price	(3) = (1)/(2) Units bought	(4) Unit balance	(5) = (4)x(2) Encashment value of plan, before tax
1	€99	€1.00	99.00	99.00	€99.00
2	€99	€1.03	96.12	195.12	€200.97
3	€99	€1.01	98.02	293.14	€296.07
4	€99	€0.98	101.02	394.16	€386.27
5	€99	€1.15	86.09	480.25	€552.28

This table illustrates two important aspects of how unit linked savings plans work:

- The fixed monthly contribution notionally secures a fluctuating number of units; as the unit price increases, fewer units are allocated to the plan, but when unit prices fall more units are allocated to the plan.

- As the number of units notionally allocated to the plan increases, so does the encashment value. This is how a capital sum is gradually built up over time from small regular savings.

9.1.2 Savings Term

Most unit linked savings plans do **not** have a fixed **savings term**, i.e., a pre-defined term of years at end of which the policy automatically matures and the encashment value is paid out.

> Unit linked savings plans are open ended, i.e. the policyholder can pay into the plan for as long as he or she wants to, and encash the plan, in full or part, at any time.

Being open ended with no fixed savings term, the saver can stop and restart his or her savings at any time.

However, because of the charges deducted from the plan and the fact that the plan is linked to unit funds which can fluctuate in value in line with investment markets, the normal recommended *minimum* savings term of a unit linked savings plan is usually 10 years.

This is because earlier encashment runs the risk of the saver getting back less than they saved. The earlier a plan is encashed the higher this risk becomes; likewise, the longer the plan is held, the lower this risk becomes.

Life assurance savings plans are therefore not suitable for very short-term savings, for example, where the saver may need the funds in one or two years to buy a new car or go on a holiday.

9.1.3 Encashment Value

The encashment value, before any tax deduction, at any time of a unit linked savings plan is usually calculated as:

Number of units x unit price at date of encashment

As unit values of most unit funds are not guaranteed and can fall as well as rise, the encashment value of a typical unit linked savings plan is not guaranteed and will fluctuate in value as unit prices rise or fall.

However, some savings plans may carry an early encashment charge similar to that applying to unit linked investment bonds.

9.1.4 Life Assurance Cover

As a unit linked savings plan is a life assurance policy, it must provide a benefit payable on death.

The level of life assurance cover, if any, on a unit linked savings plan will be much lower than on a unit linked protection policy. Indeed, some unit linked savings plans may pay back only the encashment value on death, i.e., the value the saver could have received by surrendering the policy on the day before he or she died, or this value increased by a small amount for example, 101% of the encashment value at the date of death.

The life assurance cover on a unit linked savings plan will usually be defined as the **greater** of:

- A specified monetary level of cover, if any; and,
- The encashment value of the plan at the date of death.

Example #1

Mr Wiśniewski takes out a unit linked savings plan at a monthly contribution of €100. The plan provides a specified level of life cover of 120 x monthly contribution, i.e., €12,000.

If he dies when the encashment value of the plan is €3,000, then €12,000, i.e., the greater of the specified level of cover and the encashment value at the date of death, is payable as a death benefit.

Example #2

Mr Wiśniewski takes out a unit linked savings plan at a monthly contribution of €100. The plan provides a minimum fixed level of life cover of €500.

If he dies in the first three months when the encashment value of the plan is, say, €278, the sum payable on death will be €500, i.e., the greater of €500 and the encashment value of the plan at death.

If he dies when the encashment value of the plan is €3,000, then this amount is payable as a death benefit, being greater than €500.

9.1.5 Charges

Life companies incur costs and expenses in setting up and operating a life assurance savings plan. These may include some or all of the following:

- The 1% insurance contribution levy payable to the Government, which is usually deducted from the premium before investment in units.
- Administration expenses.
- Commissions and sales remuneration payable to the insurance intermediary or sales employee who arranged the policy for the client.
- Investment management fee for the unit fund or funds in which the plan will invest.
- The cost of any life cover attaching to the plan.

Some of the costs may be incurred at the start of the plan, for example, initial commission paid to an introducing intermediary and the 1% premium levy, while others are incurred more evenly over the life of the plan for example, customer servicing administration and renewal commissions.

To meet these costs and expenses, and to provide a profit margin, the life company will make various charges against the unit linked savings plan, which may include some or all of the following:

- Non-allocation period
- 1% Insurance levy
- Allocation rate
- Monthly policy fee
- Early encashment charge
- Annual fund charge
- Intermediary remuneration
- Partial encashment charge
- Fund switching charge

Typical Savings Plan Charges

Some of these charges are similar to those already explained in Chapter 8 for unit linked investment bonds. Some charges specific to unit linked savings plans are:

Non-Allocation Period

An initial period during which the regular contribution paid to the plan is *not* used or allocated to buy units in a unit linked fund but is retained by the life company, for example, a plan might have a non-allocation period of, say, the first six months of the plan.

During this period, the plan has no encashment value, as it has no units allocated to the plan.

Monthly Policy Fee

A life company may deduct the first, say, €3 pm from each monthly contribution, *before* using the balance of the contribution to buy units.

So, for example, if a saver pays in €40 pm into a unit linked savings plan, each month the life company may deduct €3 from this *before* using the remaining [€37 pm x allocation rate] to buy units at the ruling unit price.

Alternatively, the full contribution may be allocated to buy units, but the life company encashes units each month to the value of the policy fee.

So, for example, [€40 pm contribution x allocation rate] might be used to buy units at the ruling unit price, but each month enough units would be encashed at the ruling unit price by the life company from the plan to pay for the €3, say, policy fee.

A fixed policy fee has a proportionately greater impact on a lower contribution than on a higher contribution. So, for example, a €3 pm policy fee amounts to 10% of a €30 pm contribution, but just 5% of a €60 pm contribution or 2% (€3/€150) of a €150 pm contribution.

Most life companies retain the right to increase the policy fee on a regular basis, for example, at least in line with inflation, so that if inflation was, say, 2% pa, a €3 pm policy fee, in the second year might become €3 x 1.02 = €3.06 pm, and €3.06 x 1.02 in the third year, and so on.

9.1.6 Automatic indexation of contributions

Most unit linked savings plans allow the saver to opt to have his or her regular contribution *automatically* increased each year. For example:

- The contribution might increase at a fixed rate of, say, 3% pa.

  OR

- The contribution might increase at the annual rate of inflation, to a maximum of, say, 3% pa.

9.1.7 Unit Fund Choice

A unit linked savings plan may offer a similar range of unit funds as explained in Chapter 8.1.3 for unit linked bonds.

9.1.8 Partial Encashment

Most unit linked savings plans allow savers to take a *partial encashment*, by encashing some but not all units held by the plan. The saver may then continue paying contributions and keep the plan going, building its value back up again.

9.1.9 Exit Tax

Unit linked savings plan are taxed in a similar manner outlined in Chapter 8.1.14 for unit linked investment bonds, that is:

- Unit funds earn tax free investment returns.

- On encashment or pay-out on death, any gain realised over and above the contributions paid into the plan is subject to an exit tax deduction, currently at:

  - 25% where the policyholder is a company.

  - 41% in all other cases.

- Where the pay-out arises on death, the gain is calculated as if the plan was encashed the day before the death.

- Once exit tax is deducted from the pay-out, the saver has no further personal tax liability on returns.

- A deemed encashment for the purposes of deducting exit tax on any accumulated gain, occurs on the 8^{th} and every subsequent 8^{th} anniversary of the commencement of the savings plan.

- Some savers may be able to reclaim any exit tax deducted, in certain circumstances.

- If a plan is encashed at a loss, no exit tax is due. Such a loss cannot be offset against any other gain for tax purposes.

Example #1: Savings Plan – Full Encashment – Gain

Mary took out a unit linked savings plan at a monthly contribution of €100. After 7 years, when she has paid in €8,400, she encashes the policy for €9,670.

The realised gain is calculated as (€9,670 – €8,400) = €1,270.

The life company will deduct exit tax at 41% on this gain, i.e., will deduct:

41% x €1,270 or €521 in tax from the encashment.

And so, will pay out the following to her as the encashment value:

€9,670 – (41% x €1,270) = €9,149.

Example #2: Savings Plan – Full Encashment – Loss

Mary took out a unit linked savings plan at a monthly contribution of €100. After five years, when she has paid in €6,000, she encashes the policy for €5,760.

As she has not made a gain on the plan, no exit tax is deducted from the pay-out, and so the full €5,750 is paid out to her.

Mary cannot offset this loss for tax purposes against any other investment gain she might make.

9.1.10 Projected Breakeven Point

Take, for example, a unit linked savings plan A with this charging structure:

- 100% allocation (after allowing for the 1% premium levy).
- Policy fee €3 pm taken from the monthly contribution *before* allocation to units.
- Annual fund charge of 1.25% pa.

A unit linked savings plan will have a projected **breakeven point, i**.e. a duration at which the projected encashment value of the plan, before any exit tax deduction, first exceeds the total contributions paid into the plan to date.

Let's assume an investment return of 4% pa before deducting the annual fund charge, so that the unit fund growth rate assumed is 2.75% pa:

Month	Contribution	Policy fee	Assumed unit price	Units secured	Total units held by plan	Total paid in	Projected encashment value
1	€150	€3	€1.000	147	147	€150	€147
2	€150	€3	€1.002	146.67	293.67	€300	€294
3	€150	€3	€1.005	146.34	440	€450	€442
4	€150	€3	€1.007	146.01	586.01	€600	€590
5	€150	€3	€1.009	145.68	731.69	€750	€738
6	€150	€3	€1.011	145.35	877.04	€900	€887
7	€150	€3	€1.014	145.02	1022.06	€1,050	€1,036
8	€150	€3	€1.016	144.69	1166.75	€1,200	€1,185
9	€150	€3	€1.018	144.37	1311.11	€1,350	€1,335
10	€150	€3	€1.021	144.04	1455.15	€1,500	€1,485
11	€150	€3	€1.023	143.71	1598.87	€1,650	€1,635
12	€150	€3	€1.025	143.39	1742.26	€1,800	€1,786
13	€150	€3	€1.028	143.07	1885.32	€1,950	€1,937
14	€150	€3	€1.030	142.74	2028.06	€2,100	€2,089
15	€150	€3	€1.032	142.42	2170.48	€2,250	€2,240
16	€150	€3	€1.034	142.1	2312.58	€2,400	€2,392
17	€150	€3	€1.037	141.78	2454.36	€2,550	€2,545
18	€150	€3	€1.039	141.46	2595.82	€2,700	€2,698
19	€150	€3	€1.042	141.14	2736.96	€2,850	€2,851
20	€150	€3	€1.044	140.82	2877.78	€3,000	€3,004
21	€150	€3	€1.046	140.5	3018.28	€3,150	€3,158
22	€150	€3	€1.049	140.18	3158.46	€3,300	€3,312
23	€150	€3	€1.051	139.87	3298.33	€3,450	€3,467
24	€150	€3	€1.053	139.55	3437.88	€3,600	€3,621
25	€150	€3	€1.056	139.24	3577.12	€3,750	€3,777

In this example, and based on the investment return assumption, the projected breakeven point happens in month 19, i.e., in month 19 the projected encashment value of the plan, before any tax deduction, first exceeds the total contributions paid in to date.

However, if the investment return achieved was 5% pa before deducting the annual fund charge, and hence the unit growth was 3.75% pa, the projected breakeven point is pulled forward to month 15:

Month	Contribution	Policy fee	Assumed unit price	Units secured	Total units held by plan	Total paid in	Projected encashment value
1	€150	€3	€1.000	147.00	147.00	€150	€147
2	€150	€3	€1.003	146.55	293.55	€300	€294
3	€150	€3	€1.006	146.10	439.65	€450	€442
4	€150	€3	€1.009	145.65	585.30	€600	€591
5	€150	€3	€1.012	145.21	730.51	€750	€740
6	€150	€3	€1.015	144.76	875.27	€900	€889
7	€150	€3	€1.019	144.32	1019.59	€1,050	€1,039
8	€150	€3	€1.022	143.88	1163.47	€1,200	€1,189
9	€150	€3	€1.025	143.44	1306.91	€1,350	€1,339
10	€150	€3	€1.028	143.00	1449.90	€1,500	€1,490
11	€150	€3	€1.031	142.56	1592.46	€1,650	€1,642
12	€150	€3	€1.034	142.12	1734.58	€1,800	€1,794
13	€150	€3	€1.038	141.69	1876.27	€1,950	€1,947
14	€150	€3	€1.041	141.25	2017.52	€2,100	€2,100
15	€150	€3	€1.044	140.82	2158.34	€2,250	€2,253
16	€150	€3	€1.047	140.39	2298.73	€2,400	€2,407
17	€150	€3	€1.050	139.96	2438.69	€2,550	€2,561
18	€150	€3	€1.054	139.53	2578.22	€2,700	€2,716
19	€150	€3	€1.057	139.10	2717.32	€2,850	€2,872
20	€150	€3	€1.060	138.68	2856.00	€3,000	€3,027

Therefore, the projected breakeven point is highly dependent on the rate of investment return achieved.

9.2 Assessing Savings Needs

9.2.1 Identifying Savings Needs

Following a fact-finding process and the establishment of the client's financial plans and objectives, you may have identified that the client has a **savings need**, i.e., a need to accumulate a capital sum over time from surplus earned income to meet the cost of some future financial objective or expense for which the client is otherwise unlikely to have sufficient available capital by the time it will be required.

9.2.2 Emergency Fund

Each client should first have a readily accessible **emergency fund**, which can be called on to meet sudden unexpected expenses and income shortfalls, for example, a medical emergency, house repairs, redundancy, etc.

Typically, such an emergency fund should:

- Be at least six months' net regular income.

  AND

- The funds should be accessible at very short notice without penalty.

If a client doesn't already have the desired level of minimum emergency fund, this should be their savings need priority. This fund is best built up in a demand bank deposit or State savings account; a life assurance savings plan is not appropriate to the accumulation and investment of a client's emergency fund as early encashment might result in a loss.

9.2.3 Quantifying the Long-Term Savings Need

The extent of the client's existing investments and savings commitments will directly influence the level of capital required to meet a specified future financial objective, i.e., the level of the additional long-term savings need.

It is therefore important to identify those capital assets and savings that are likely to be available to meet the client's financial plans and future objectives, as these will reduce or possibly eliminate the need for additional savings.

Example #1

Following a fact-find a client tells you that he already has a unit linked savings plan for €258 pm.

However, further investigation reveals that the plan is actually assigned to a lending institution as security for a loan.

The capital built up in this plan is therefore not currently available for other purposes other than repayment of the loan unless there is a surplus after repaying the loan.

Where a client has 'free' savings and investments, i.e., not dedicated for some other purpose and readily available, these should be deducted from the estimated capital required to meet the identified financial objectives to arrive at the long-term savings need, i.e., the shortfall in capital that needs to be accumulated from surplus income over a period of time.

Example #2

A client wants to help his son to buy his first home in the future, by providing a deposit when he comes to buy a home. His son is now aged 16. Let's say that a typical house deposit required would currently be €75,000.

Let's assume that the child will want to buy a house 14 years from now.

If we allow for inflation in housing prices, say at 2.5% pa, then €75,000 x 1.413,* say €106,000 will be needed as a deposit in approximately 14 years.

The client has some €45,000 invested in a unit linked investment bond, apart from his emergency fund and other short-term savings. He is happy that the bond should be used fully to fund his son's deposit in 14 years' time. Assuming the bond can achieve a return of, say, 3% pa after taxes and charges, the projected position after 14 years might be:

Target fund required:	€106,000
Less projected bond value:	€68,067
Projected Shortfall in fund required in 14 years' time:	**€37,933**

Therefore, the long-term savings need in this case is to accumulate a fund of about €38,000 after 14 years, by saving from income, to supplement the client's existing investments.

9.2.4 Funding Gift Tax – Section 73 Policy

A life assurance savings plan can be used to accumulate capital to be used after 8 years to pay Gift Tax for a beneficiary on receiving a gift received from the policyholder. The payment of a beneficiary's Gift Tax liability by the policyholder in this manner is itself exempt from Gift Tax, i.e. it is not treated as another gift made by the policyholder.

Gift Tax is similar to Inheritance Tax but applies to gifts received by an individual from another person; Inheritance Tax applies to inheritances received on a death.

Gifts are taxed at the same rates and as part of the same lifetime thresholds for CAT as an inheritance would be:

Group threshold	Relationship of beneficiary to disponer, i.e., person providing the inheritance	Threshold amount
A	a child (including adopted child, stepchild, and certain foster children) or minor child of a deceased child of the disponer.	€335,000
B	a brother, sister, niece, nephew, or lineal ancestor or lineal descendant of the disponer.	€32,500
C	All other cases.	€16,250

Gifts to one's spouse or civil partner are exempt from Gift Tax.

The threshold above applies to the total gifts *and* inheritances received by an individual.

In addition, the first €3,000 gift received in any one year from **any** person is exempt from Gift Tax.

The Gift Tax rate is currently 33%.

* Refer to accumulation factors in Chapter 13.

Example

Mikołaj plans on gifting assets to his daughter, Alicja, in 10 years. The projected value of the assets in 10 years is, say, €600,000. Alicja has not received any prior gift or inheritances from any source and is not expected to do so over the next 10 years.

Taking the current Class, A threshold of €335,000 and the current Gift Tax rate of 33%, Alicja's estimated Gift Tax liability in 10 years is:

[€600,000 gift - €3,000 (annual exemption) - €335,000 Threshold] x 33% =

€262,000 x 33% = €86,460.

Alicja therefore on taking the gift will have an estimated Gift Tax liability of €86,460, based on the assumptions above.

If in 10 years, Mikołaj decided in addition to gifting Alicja assets worth €600,000 to also pay Alicja's Gift Tax liability of €86,460 out of his own funds, this would be treated as another taxable gift for Alicja, with an additional Gift Tax liability for Alicja of 33% x €86,460 = €28,532.

If Mikołaj wanted to completely clear Alicja's Gift Tax liability, leaving her with the gift of the assets worth €600,000 and no residual Gift Tax liability, he would have to gift her some €86,460 / (1- 33%) = €129,045 in addition to the gift of the assets.

However, if Mikołaj had now started saving regularly for at least 8 years through a life assurance savings plan, arranged under **Section 73** Capital Acquisitions Tax Act, 2003, he would only need an estimated €86,460 in the plan after 10 years to pay Alicja's Gift Tax liability, as the payment of Gift Tax for a beneficiary with the proceeds of a savings plan arranged under Section 73 does *not* create another Gift Tax liability for the beneficiary.

Therefore the benefit of using a Section 73 savings plan is that after 10 years, based on the assumptions above, Mikołaj needs €86,460 to pay off Alicja's Gift Tax liability, but if he didn't use a Section 73 savings plan he would need €129,045 to fully discharge her Gift Tax liability.

For the Section 73 relief to apply on the use of a life assurance savings plan to pay Gift Tax for a beneficiary, without this triggering another taxable gift, the following conditions must be complied with:

- The savings plan has to be expressly effected at the outset under Section 73 Capital Acquisitions Tax Act, 2003. This might be done by indicating this intention on the application form or in a separate covering letter from the policyholder.
- Regular contributions must be paid to the plan for at least 8 years.
- A contribution paid in any one year can't be less than 50% of the highest contribution paid within the previous 8 years; so reasonably regular contribution amounts must be saved over the savings period, which must be at least 8 years.
- When the plan is encashed, the gift giving rise to the Gift Tax liability must be made within one year of encashment.

There is no compulsion to use a savings plan effected under Section 73 to pay Gift Tax. The client can encash the plan at any time and use the proceeds for some other purpose.

9.2.5 Affordability

In order to commit to a long-term regular savings plan, a client needs to have sufficient regular surplus income *after* normal living costs including loan repayments and important protection needs have been met.

The amount of surplus income which the client expects to have regularly available for saving will usually be identified from the fact-find and should be confirmed with the client.

This amount is important for two reasons:

- It indicates the **maximum** amount available to meet identified savings needs;

- Where there are no identified unfulfilled short-term savings needs, the monthly surplus income may represent an amount that is available for longer term savings.

  In this case, it can be argued that the regular surplus income is itself the longer-term savings need, i.e., a need to siphon off this surplus income from current expenditure and use it to accumulate capital for the future.

9.3 Benefits

The main benefits unit linked savings plans offer are:

- A facility to accumulate a capital lump sum from regular income over a long period of time that will hopefully beat inflation.

- Savings can be invested in a wide rate of professionally managed investment funds, which accumulate tax free, subject to exit tax being deducted from any gain paid out and every 8 years.

- By investing a fixed amount on a regular monthly basis, the saver is less exposed to the timing risk of investment as unlike an investment bond the regular savings are spread out and invested over a long period of time.

- The saver can usually reduce, suspend, recommence or terminate his or her savings at any time.

- Addition of optional life cover, in some cases.

9.4 Limitations

The main limitations associated with unit linked savings plans are:

- Not suited to short-term savings needs, as minimum recommended savings term is 10 years.

- Non-taxpayers cannot reclaim any exit tax deducted from an encashment value.

- Restrictions may be placed on switches out of a property fund in certain circumstances for up to six months, or longer, if fund is short of cash.

9.5 Risks

The main risks associated with unit linked savings plans are:

- The saver could get back less than the amount saved; this can arise through a combination of investment risk, and plan charges, and encashing the plan too early.

- The saver could get back less than the anticipated or targeted amount shown to the saver at the outset if the unit fund or funds to which the plan is linked produces a lower investment return than anticipated or assumed at the outset and/or plan charges turn out higher than expected.

- The plan may produce a return less than inflation, and so the plan value fails to keep pace with inflation.

- The saver's financial circumstances could change which might require the saver to reduce or suspend his or her regular savings due to an interruption in surplus earned income.

9.6 Comparing Unit Linked Savings Plans

Where a client has an identified long-term savings need, there may be more than one type of life assurance unit linked savings plan which can meet that need.

In determining the suitability of such plans to meet the client's savings needs, the following plan features should be identified and compared:

Minimum contribution	Maximum contribution	Savings term	Fund choice
Other benefits	Charges	Flexibility	Access

Minimum Contribution

What is the minimum monthly contribution under each of the plans? This will be relevant if some plans have a minimum requirement higher than the regular savings the client is committed to making.

Maximum Contribution

Does any of the plans have a maximum contribution amount?

Savings Term

What fixed or variable savings terms are provided by the different plans? It is important to match the client's desired savings term as closely as possible with the savings terms of the plan.

Fund Choice

What fund or funds are offered by each plan? Some plans may have a narrow range of funds, while others may have a wider range of funds which may offer a better match to the client's attitude to investment risk.

A plan should ideally have at least one secure fund option.

Other Benefits

Are there are other benefits attaching to the plan or may be optionally added, such as life cover or waiver of contribution? What is the cost of these additional benefits?

Charges

What charges will apply to each plan, at the anticipated level of savings the client will make for the client's anticipated savings term:

- Initial charges, for example, non-allocation period, etc.

- Recurring charges, for example, annual fund charges, allocation rates less than 100%
- Early encashment/termination charges
- Other charges, for example, partial encashment, fund switching, etc.

Do charges vary by the size of the saving, and/or by the length of time the plan is held?

One way of comparing the impact of charges is to look at the respective projected breakeven points and/or **reduction in yield** (RIY)[9], on similar investment return assumptions for the same contribution and savings term.

Flexibility

What flexibility is there for the client to reduce, suspend, recommence saving and/or vary the savings term of the plan later on?

This may be important where a client's current income is unpredictable and/or his or her job security is questionable.

What charges might apply if the client wants to reduce, suspend, recommence saving and/or vary the savings term of the plan later on?

Access

What access is there to part or all of the accumulated savings? Do any potential penalties or charges apply on part or total encashment?

[9] *See Chapter 13.4.*

Review

Now consider the main teaching points, which were introduced in this Chapter. They are listed below. Tick each one as you go through them.

- [ ] The main features, benefits, limitations, and investment risks of *unit linked savings plans*
- [ ] Assessing a client's savings needs
- [ ] Comparing unit linked savings plans

Sample Questions

The answers to these questions can be found in your Study Hub.

1. Noel has a unit linked savings plan which currently has 12,456 units in the life company's Managed Fund. If the current unit price of the fund is €1.455, what is the current encashment value (to the nearer whole Euro) of Noel's plan, before any exit tax and any early encashment charge deductions?

   A. 16,354
   B. 17,214
   C. 18,123
   D. 19,077

2. The projected 'breakeven point' under a unit linked savings plan is the duration at which:

   A. the projected encashment value, before exit tax, first exceeds the total paid into the plan to date.
   B. the early encashment charge no longer applies.
   C. bonus units are first added to increase the plan value.
   D. exit tax is first deducted from the plan value.

3. A unit linked savings plan protects the saver from which risk when saving?

   A. Investment.
   B. Timing.
   C. Counterparty.
   D. Inflation.

4. Which of the following could be calculated to compare the impact of charges on different unit linked savings plans?

   (i) Projected breakeven points.
   (ii) Reduction in Yield.
   (iii) Annual Equivalent Rate.

   A. (i) only.
   B. (ii) only.
   C. (i) and (ii) only.
   D. (i), (ii) and (iii).

10

Taxation

This Chapter gives a brief overview of how income tax and USC work, including the various Schedules used to classify income for tax purposes. The use of standard rate tax bands and tax credits are also examined.

Learning Outcomes – after studying this chapter you should be able to:
explain the main income tax Schedules;
set out the various income tax bands, tax credits, tax exemption limits and tax rates;
explain how Universal Social Charge (USC) is calculated and the income it applies to; and
calculate an individual's personal income tax and USC liability, given their income and personal circumstances.

Chapter weightings	Number of questions which may appear		
In the exam, questions are taken from each Chapter based on the following approximate chart:	Chapter	Minimum	Maximum
	10	2	4

10.1 Income Tax

An individual pays income tax on any taxable income earned or received in a calendar year. For income tax purposes, income is classified under a number of different headings or **Schedules**. The main ones are Schedule D, E and F.

Schedule D, in turn, is divided into several different **cases**:

Schedule	Type of income
Schedule E	• Salary and wages arising from an employment. • Benefits in kind provided by an employer for an employee. • Pensions and annuities. Normally, Schedule E income is subject to PAYE, PRSI and Universal Social Charge (USC) deduction at source.
Schedule D – Case **I** & **II**	• Income from a self-employed trade (**I**) or profession (**II**).
Schedule D – Case **III**	• Dividends, rents and interest from foreign investments.
Schedule D – Case IV	• Deposit interest subject to DIRT, and other miscellaneous types of income.
Schedule D – Case V	• Rental income from an Irish property.
Schedule F	• Dividends from an Irish resident company.

Schedule E and Schedule D Case **I** and **II** (in bold above) relate to *earned income*, while the other schedules relate to *unearned income*.

Income tax is levied for the 2024 tax year on taxable income as follows:

Taxable income up to **standard rate** band	20%
Excess at **higher rate**	40%

Each taxpayer has a **standard rate tax band,** i.e., a level of taxable income subject to standard rate tax, and personal tax credits to be offset against their resulting income tax liability. Any income above this level is taxed at the top or higher rate.

The level of standard rate band varies by the civil status of the taxpayer and whether one or both spouses/civil partners are working.

A **tax credit** is a credit or deduction against an individual's income tax liability.

Tax credits are allowed in respect of the following items:

- Personal allowance.
- Spouse's carer allowance.
- Other allowances, for example, age allowance, blind allowance, incapacitated child allowance and dependant relative allowance.
- Employee tax credit.
- Earned income tax credit for the self-employed, including proprietary directors.

	Standard rate tax band 2024	Personal tax credit 2024
Single/widowed	€42,000	€1875/€2415
Married couple/civil partners, one income	€51,000	€3,750
Married couple/civil partners, two incomes	€84,000 (transferable between spouses; max one spouse €51,000	€3,750
One parent family	€46,000	€1,750(additional)
Employee credit	-	€1,875 (max)
Earned income credit for self-employed	-	€1,875 (max)

In addition to paying employees a salary, some employers provide non-cash **benefit in kind (BIK)** or additional perks to employees (either to all employees or, more usually, to selected employees).

These perks can take many forms, but perhaps the most common are:

- The provision of a company car (most usually for senior managers and sales representatives).
- The provision of mortgages or loans at rates of interest, below those generally available (more common with employees of the major banks and insurance companies).
- Payment of medical expense insurance contributions, for example, VHI contributions on behalf of employee.

The value of BIKs is liable to income tax, PRSI and USC under the PAYE as if it was salary or wages paid to the employee.

Taxpayers can also claim tax relief on certain medical expenses at the standard rate of income tax.

10.2 Universal Social Charge (USC)

A tax called the Universal Social Charge (USC) is also payable on an individual's income from all sources, i.e., on income *before* deduction of any tax reliefs, etc.

The standard rate of USC payable in 2024 is as follows:

Total income subject to USC	USC rate
The first €12,012	0.50%
The next €13,748	2.00%
The next €44,284	4.00%
Balance	8.00%

The 2.00% USC rate applies to all income in excess of €12,012 for:

- Those aged 70 or over with total income (excluding the State Pension) of less than €60,000; and,
- Those aged under 70 with total income (excluding the State Pension) less than €60,000 and who hold a medical card.

All individuals with total income less than €13,000 are exempt from USC in 2024.

The following types of income are **not** subject to USC:

- Department of Social Protection pensions, benefits, and similar payments, for example, the State Pension.
- Deposit interest subject to DIRT.
- Dividends paid by credit unions to their members.
- Returns from life assurance and collective investment fund investments.
- The tax-free part of ex-gratia redundancy payments paid by employers.

Where income is taxed under the PAYE system, the USC is applied to the gross income, **before** deduction of pension contributions, reliefs, tax credits, etc.

Note that in the case of a married couple with two incomes, the USC is applied **separately** to each spouse's income as per the table above.

10.3 Tax Calculation Example

The general outline of how income tax and USC is charged is as follows. The example is assumed to refer to a married couple with *one* earned income, an employee who is *not* a proprietary director, and both are under age 65.

Total gross income from all sources, earnings, taxable investment income, etc.	Salary Schedule E: €95,000 Gross dividends from an Irish company: Schedule F: €5,000[10] **Total: €100,000**
LESS	
Any *charges* on income, such as tax-deductible maintenance payments, allowable covenant payments, etc.	Gross covenant payment, assumed: - €1,000
LESS	
Reliefs, such as personal pension plan contributions, PRSA contributions, personal contributions to occupational pension schemes, IP contributions.	Gross PRSA contribution: - €2,000
Taxable income	**€97,000**
Standard rate tax band	€51,000 (married couple, one income) at 20%: €10,200
Balance taxable at 40%	€46,000 at 40% = €18,400
Total income tax	**€28,600**
LESS	
Tax credits:	Married tax credit: €3,750 Employee tax credit: €1,875 Dividend Withholding Tax on dividends: €1,250 Medical expenses (€2,000 at 20%) €400 Total credits **€7,275**
PLUS	
Add back tax deducted and due to Revenue	Tax deducted on covenant payment: €200
Total income tax liability for 2024	**€28,600 - €7,275 +€200 = €21,525**
PLUS, USC First €12,012 at 0.5% Next €13,748 at 2% Next €44,284 at 4.0% Balance of €29,956 at 8%	 € 60 € 275 € 1,771 € 2,396 **€4,502**
Total income tax and USC liability for 2024	**€26,027**

[10] *Before Dividend Withholding Tax of 25%*

10.4 Income Tax Exemption Limit

An important relief for income tax is the age **income exemption limit**, which exempts individuals aged 65 and over totally from income tax (but not from the USC) where their total income from all sources, i.e., **before** reliefs and tax credits, in 2024 tax year does not exceed €18,000, or €36,000 for a married couple/civil partners where at least one of them is age 65 or over.

Individuals in receipt of the State Pension income only would therefore not be liable to income tax on it:

Married couple/civil partners (age 65 and over)	2024 tax year
Income tax exemption limit	€36,000
State Pension (Contributory)* (individual + maximum adult dependant (over age 66) increase)	€27,441 pa
State Pension (Contributory)* (both qualifying for maximum pension in own right)	€28,939 pa

**State Pension (Contributory) becomes payable from age 66, currently.*

Review

Now consider the main teaching points, which were introduced in this Chapter. They are listed below. Tick each one as you go through them.

- Income Tax ☐
- Universal Social Charge (USC) ☐
- Tax calculation example ☐
- Income Tax exemption limit ☐

Sample Questions

`

The answers to these questions can be found in your Study Hub.

1. Income from a self-employed profession is assessed to income tax under:

   A. Schedule D Case I.
   B. Schedule D Case II.
   C. Schedule E.
   D. Schedule F.

2. Salary and wages arising from an employment are assessed to income tax under:

   A. Schedule D Case I.
   B. Schedule D Case II.
   C. Schedule E.
   D. Schedule F.

3. The Universal Social Charge does NOT apply to:

   (i) the State Pension (Contributory).
   (ii) deposit interest.
   (iii) returns from collective investment funds.

   A. (i) only.
   B. (i) and (ii) only.
   C. (ii) and (iii) only.
   D. (i), (ii) and (iii).

4. Daniel is aged 72 and does not hold a medical card. Daniel pays a lower rate of USC if his total income is less than:

   A. €60,000
   B. €65,000
   C. €70,000
   D. €75,000

11

Starting a Policy

This Chapter examines the legal and regulatory process by which a client takes out a life assurance policy, including completing the proposal form, underwriting, acceptance and issue of the policy by the life assurance company.

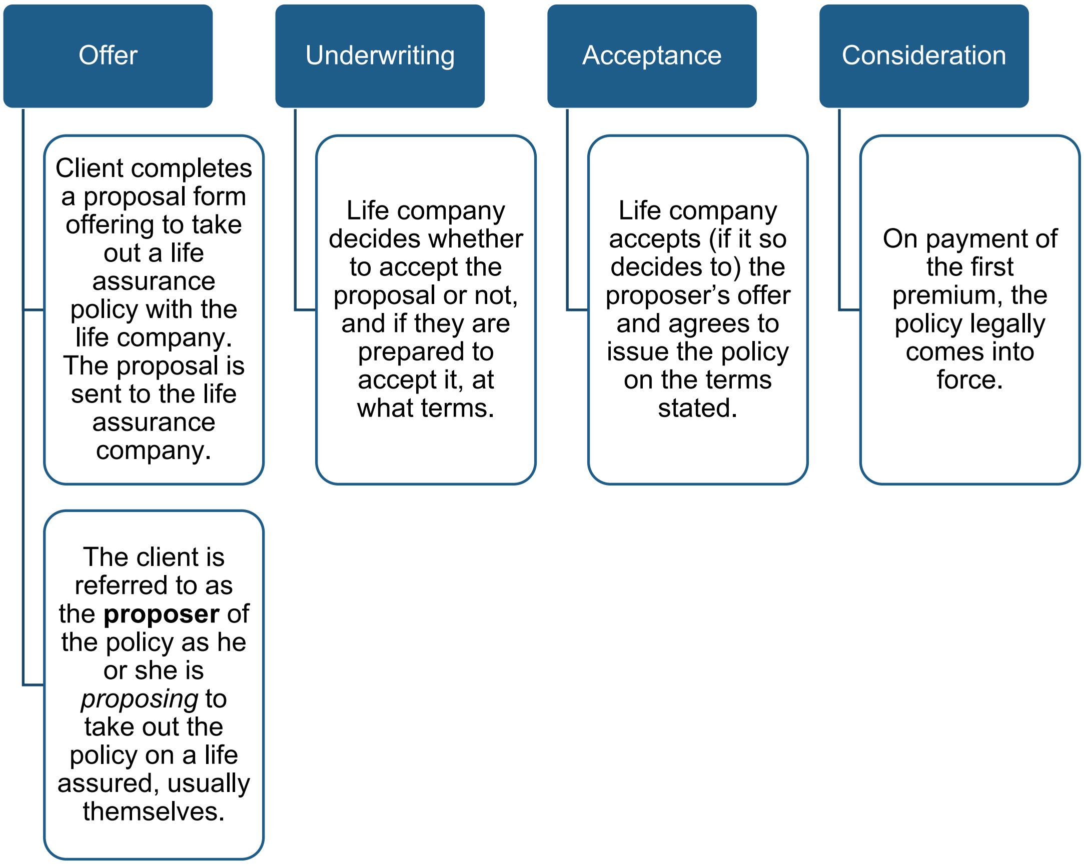
Learning Outcomes – after studying this chapter you should be able to:
describe in detail the four steps involved in a client taking out a life assurance policy: - completion of a proposal form; - underwriting the application; - acceptance, or otherwise, of the application; and - issue of the policy, where the life assurance company has accepted the application for the policy.
explain what reinsurance is, and why life companies use it.
explain the rationale for writing policies under trust;
explain the Disclosure of Information which a client will get, both on taking out a policy and on an ongoing basis; and

Chapter weightings	**Number of questions which may appear**		
In the exam, questions are taken from each Chapter based on the following approximate chart:	Chapter	Minimum	Maximum
	11	8	12

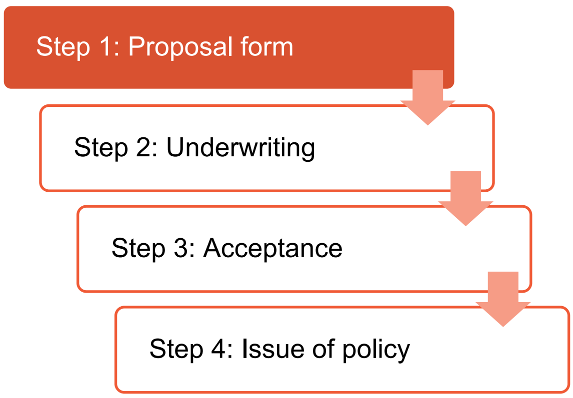
11.1 A Legal Contract

A life assurance policy is a **legal contract** between the life assurance company and the policyholder (sometimes referred to as the **grantee** of the policy).

The main steps in the commencement of a life assurance policy are:



11.2 Step 1: The Proposal Form



The first step for a client who wants to take out a policy is to fill out and sign a life company **proposal form,** so called because by filling out this form and giving it to the life company (usually through an insurance intermediary), the individual is *offering* or *proposing* to take out a policy with the life company concerned. Sometimes this proposal form is alternatively called an **application form**.

A life company will usually have different types of proposal forms for different types of policies.

A life company may have a **short** proposal form for savings plans, investment bonds and pension plans, but may have a much longer proposal form for protection policies where more questions about the life assured's state of health are asked.

Where the proposer and the life assured are different persons, i.e., a life of another policy, both have to complete the proposal form and sign it. Also, in the case of joint life policies, both must sign the proposal form.

11.2.1 The Proposal Form

The proposal form will usually have the following main sections:

Personal Details

- Name, address and telephone number of the proposer.
- Date of birth, gender and marital status.

Policy/Cover Details

- The type of policy being sought, and the type and level of benefits required, for example, how much life cover is required, what ancillary benefits are being taken, etc.
- The level of premium to be paid under the policy, and whether the premium is once off or a regular premium payable at a particular frequency, for example, monthly.
- How the premium will be paid, for example, by direct debit, cash, payroll deduction etc. Most regular premiums are paid by direct debit or standing order from the client's bank account, but some pay by deduction from salary at work through a group deduction scheme.

Health Questions

Where the policy is a protection policy, i.e., provides life and/or Serious Illness cover benefits:

- Questions about the life assured's height, weight, current and recent state of health, smoking and drinking habits, and medical history.
- Questions regarding the nature of any hazardous activities or hobbies the life assured may engage in, for example, rock climbing, scuba diving, etc.
- The name and address of the life assured's GP.

Declaration and Signature

- At the end of the form, the proposer and life assured (if different to the proposer) sign a declaration stating that all answers given in the proposal form are true and complete, and also giving the life company permission to seek medical records and information from any doctor or medical consultant who has attended the life assured in the past.
- The declaration also authorises the life company to seek information from any other life company to which the individual has proposed for a policy.

Authority to Deduct/Pay Contributions

- Where there will be a regular premium payable, the proposer will usually complete and sign a bank **direct debit** or standing order authority to enable the life company to collect contributions from their bank account if the policy goes ahead.
- In some cases, the regular premium may be payable by **payroll deduction** instead of by direct debit. In this case the proposer will sign an authority to give their employer permission to deduct the premiums from their salary or wages and remit to the life assurance company.

11.2.2 Consumer Protection Code

The Central Bank's Consumer Protection Code imposes a number of specific requirements on an insurance intermediary or life company when advising consumers proposing for different types of protection policies:

- **The life company/intermediary dealing with the client must explain to him or her, at the proposal stage, the consequences of failure to make full disclosure of relevant facts** to the life company on the proposal form, including:

    - Their medical details or history; and,

    - Previous insurance claims made by the client for the type of insurance sought.

    The explanation must include, where relevant:

    i. That a policy may be cancelled.

    ii. That claims may not be paid.

    iii. The difficulty the client may encounter in trying to arrange insurance elsewhere.

- **Prior to a client completing a proposal form for an Income Protection (IP) policy**, the intermediary dealing with the client must explain to the client:

    - The meaning of disability as defined in the policy;

    - The benefits available under the policy;

    - The general exclusions that apply to the policy; and

    - The reductions applied to the benefit where there are disability payments from other sources.

- **Prior to a client completing a proposal form for a Serious Illness policy**, the intermediary must explain clearly to the client the restrictions, conditions and general exclusions that attach to that policy.

11.2.3 Principle of Insurable Interest

A policy where the proposer and the life assured are the same person is referred to as an **own life** policy.

A protection policy can be arranged on a **life of another** basis, i.e., where the proposer and life assured are different people.

Example

Mr Kazlauskas insures his wife for €250,000. On her death, the life company will pay €250,000 to the policyholder, i.e., Mr Kazlauskas.

In the above case Mr Kazlauskas, as the policyholder or grantee, is the legal owner of the policy at all times. Mrs Kazlauskas is the life assured but has no legal right under the policy at any time.

Up until the introduction of the Consumer Insurance Contracts Act 2019 on 1st September 2021, the proposer needed to have what was called an **insurable interest** in the life assured at the time the policy was issued, at least up to the extent of the cover sought.

This meant, the law required the proposer to prove an insurable interest in the life assured, to the extent of the sum assured proposed for, *at the time the policy was taken out*.

For example, a son couldn't insure his father unless he was able show that he would lose financially by his father's death, i.e., show an insurable interest in his father's life at the time the policy is taken out, to the extent of the sum assured sought.

Since the introduction of the Consumer Insurance Contracts Act 2019 on 1st September 2021, an insurer cannot reject a claim from a proposer just because the proposer did not have an insurable interest in the life assured at the time the policy was effected. However, at underwriting stage, insurers can still take account of whether or not the proposer would lose financially by the death of the life assured, and to what extent.

The insurer is also not relieved of the liability that exists because the proposer who will ultimately benefit under the contract is not specified.

11.2.4 Declaration of Trust

Some own life policies are written **under trust**, i.e., the proposer in addition to completing the proposal form also completes a Declaration of Trust instructing the life company to issue the policy sought to a nominated trustee or trustees who will legally own the policy. In some cases, the proposer themselves may be the sole or one of the trustees.

On death, the death benefit proceeds of a policy arranged under a Declaration of Trust is paid to the surviving nominated trustee(s) and **not** to the proposer's or life assured's estate.

In the Declaration of Trust, the proposer will usually set out the potential beneficiaries of the policy and/or the use of the funds, and so after death, the trustees will pay out and use the policy proceeds in accordance with the terms of the Declaration of Trust.

A policy arranged under a Declaration of Trust cannot be assigned.

Life assurance policies are arranged under a Declaration of Trust for three possible reasons:

- **Partnership Insurance**, where the cover is arranged on an own life in trust basis; on death, the proceeds are paid to the trustees nominated in the Declaration of Trust, who in turn will pay out the funds in the specified proportions to the surviving business partners to enable them to buy back the deceased's share of the business. See Chapter 6.2.3.

- **Inheritance Tax**, where the policy is arranged under Section 72 of the Capital Acquisitions Tax Act 2003 to pay Inheritance Tax and other taxes arising on the death of the life assured. On death, the proceeds are paid to the trustees nominated in the Declaration of Trust, who will then use the funds to pay Inheritance Tax for the specified beneficiaries in the specified proportions. See Chapter 4.2.8.3.

- **Where the proposer wishes the funds to be paid to/used by one or more specific beneficiaries**. The proposer may want to ensure that the policy proceeds on death go to one or more specific beneficiaries, in the proportions specified by the proposer, and not go through his or her estate where the funds could be subject to Succession Act claims by next of kin.

11.2.5 Provide a Disclosure of Information Notice

Before the proposer signs the proposal form for most policy types, they must be given a **Disclosure Notice**, which may also be known under other names such as *Key Features*, *Customer Information Notice*, etc.

This notice is provided under the Life Assurance (Provision of Information) Regulations, 2001. These regulations provide for:

- Disclosure of certain information to the client in writing at the point of sale of a life assurance policy, by the intermediary or insurer.

- Disclosure of certain policy specific information to the policyholder, at the time of issue of the policy.

- The provision of an annual statement of value to certain policyholders.

- Anti-churning provisions. The term **churning** refers to the practice of persuading a client to cancel an existing policy and take out a new one in replacement, solely or mainly to generate additional sales remuneration for the insurance intermediary/salesperson involved.

The Regulations impose a requirement on both the life company and insurance intermediary to provide certain information in writing to a consumer before the consumer signs the proposal form.

In practice, the life company provides the information to the intermediary/adviser, who then provides it to the consumer.

11.2.5.1 Information to be Provided

The information to be provided must follow the format set out in the Regulations, i.e., follow the following headings:

1. Make sure the policy meets your needs.

2. What happens if you want to cash in the policy early or stop paying contributions?

3. What are the projected benefits under the policy?

4. What intermediary/sales remuneration is payable?

5. Are returns guaranteed and can the contribution be reviewed?

6. Can the policy be cancelled or amended by the insurer?

7. Information on taxation issues.

8. Additional information in relation to your policy.

11.2.5.2 Table of Projected Benefits

Under heading three, a table of projected benefits must be included, following this format:

Illustrative Table of Projected Benefits and Charges

Year	A € Total amount of contributions paid into the policy to date	B € Projected investment growth to date	C € Projected expenses and charges to date	D € Projected cost of protection benefits to date	E € Taxation to date	F = A+B-C-D -E € Projected policy value *after* payment of taxation
1						
2						
3						
4						
5						
10						
15						
20						
MATURITY						

In the case of a policy which does not provide any protection benefits, for example, a lump sum investment bond, column D is dropped.

The table is prepared on a cumulative to date basis, i.e., the figures for year five show the projected total contributions, investment growth and expenses over the first five years.

The table of projected benefits is prepared on the basis of an assumed investment return before charges. Society of Actuaries in Ireland guidance requires life companies to prepare the illustration based on an assumed investment return whose maximum value is determined by the asset split or mix of the unit fund(s) to which the policy will be linked, using the following assumptions:

- The gross maximum investment return for equities and property will be 4.5% pa.
- The gross maximum investment return for fixed interest securities will be 1% pa.
- The gross maximum investment return for cash will be 0% pa.

The rate of investment return so determined is subject to a maximum value of 4.5% pa.

Example

A life assurance savings plan will be linked to a managed fund, which is currently invested as follows:

- 50% equities.
- 25% property.
- 20% fixed interest securities.
- 5% in cash.

Using the assumptions listed before this example, the *maximum* return (before the deduction of the annual fund charge) which can be used to illustrate the table of projected benefits is worked out as:

50% x 4.5% + 25% x 4.5% + 20% x 1% + 5% x 0% = 3.58%.

Beneath the table of projected charges, the projected **reduction in yield (RIY)** must also be shown for savings plans and investment bonds. The projected RIY illustrates the projected impact of charges on the investment return, by expressing the impact of the projected charges over the life of the policy to maturity as a reduction in the gross investment return assumed.

For example, if the projected reduction in yield to maturity of a policy is 1.6% pa, i.e., while the illustration of benefits and charges assumes a 4.5% pa return before charges, the impact of the expenses is to reduce this projected return after charges over the period to maturity to 2.9% pa, i.e., 4.5% – 1.6% = 2.9% pa.

(See Chapter 13.4 for more details on reduction in yield.)

11.2.5.3 Specific/Generic Disclosure

Because the final details of the proposed policy, i.e., what contribution the proposer will pay, etc., may not be known at the proposal stage, the Disclosure Notice provided at the proposal stage is usually a **generic** one, i.e., it will be pre-printed and will be based on an assumed typical age, sex, smoker status, premium, term, cover etc., for that type of policy. It will not, therefore, be based on the specific details of the life assured, premium, term, etc., of the policy being proposed for.

However, if a generic Disclosure Notice is given to the client at the point of sale, then a **policy specific** notice, i.e., one based on the actual life assured, contribution and cover, etc, of the policy being taken out, must be given to the client when the policy is subsequently issued. A different (to that outlined above) type of generic[11] disclosure document must be provided for life assurance savings plans and investment bonds, called a **PRIIPS**[12] ***key information document (KID)***. The PRIIIPS KID (maximum three pages long) provides information about the savings plan or investment bond under these headings:

[11] *That is, based on a typical savings or investment amount for that type of policy.*

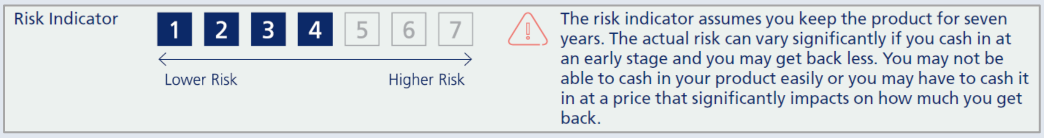
[12] *Short for packaged retail insurance and investment products*

What is this product?

This section includes the objectives of the policy and a description of the type of consumer to whom the policy is intended to be marketed, in particular in terms of the consumer's ability to bear investment loss and the investment horizon.

What are the risks and what could I get in return?

This includes a summary risk indicator of the unit fund or funds in which the policy may invest. This is an example:



A projection of the returns from the policy under different scenarios is also set out over a number of years (for example, 1, 4, and 7) under different investment scenarios:

- Stress.
- Unfavourable.
- Moderate.
- Favourable.

What happens if [the name of the life company] is unable to pay out?

What are the costs?

This section includes a projection of the cash costs, and associated reduction in yield, on encashment after 1, 4, and 7 years. This section also shows the composition of costs, split between:

- Once off costs, split between entry and exit costs.
- Ongoing costs, split between portfolio transaction costs (i.e., costs of buying and selling investments in the fund or funds in which the policy will invest) and other ongoing costs such as the annual fund charge.

How long should I hold it, and can I take money out early?

This section will set out the recommended minimum period for which the policy should be held, for example, for a bond it might be 5 years, for a savings plan it might be 7 or 10 years.

How can I complain?

Other relevant information

11.2.5.4 Anti-Churning Provisions

A client's existing assets and policies must be considered when quantifying the amount required to meet the client's needs and when giving advice. Current policies will usually reduce the need for further cover.

Existing life assurance policies can sometimes present a dilemma for insurance intermediaries; whether to advise retention or surrender of those policies.

Ethics and the Central Bank Consumer Protection Code demands that **the decision must be in the client's best interest** and NOT be influenced by consideration of the sales commission or other earnings potential for the intermediary arising from the sale of a new policy to replace the existing one.

Therefore, in the great majority of cases, the intermediary should recommend a continuation of the existing policies, unless they are either clearly unsuitable for the client's circumstances, both present or anticipated, or in some way merit replacement with a new more suitable policy (perhaps, especially with Term Assurances, where the current premium can be reduced by a similar policy with similar cover with an alternative life company).

Under the Disclosure Regulations, if an intermediary is aware that the policy recommended to the client will replace in whole or part another policy held by that client, and that other policy is to be cancelled or reduced:

- **The intermediary must advise the client of the financial consequences of such replacement and of the possible financial loss arising**.

  In particular, the effect of early surrender of the existing policy must be quantified as far as possible. Care should always be taken to inform the client clearly whether or not all or part of the premiums already paid will be lost if early surrender of an existing policy takes place.

  Difficulties could also arise with continuation of cover. For example if an intermediary advises a client to terminate an existing policy providing protection cover, and the intermediary is then unable to replace the same cover for the client on similar terms, for example, ordinary rates, or is unable to obtain fresh cover at all due to life assured's medical situation at that time, a disastrous situation can then arise where the client is left with no cover, as a result of the advice.

  With regard to Serious Illness cover, the new policy may not cover the same range of illnesses or have more restrictive definitions on particular illnesses than the current policy.

- **The intermediary and client must both sign a declaration verifying receipt of the information supplied in the Disclosure Notice**.

This declaration is usually embedded in the proposal form. The prescribed format of the declaration is as follows:

DECLARATION UNDER REGULATION 6(3) OF THE LIFE ASSURANCE (PROVISION OF INFORMATION) REGULATIONS, 2001.

WARNING

If you propose to take out this policy in complete or partial replacement of an existing policy, please take special care to satisfy yourself that this policy meets your needs. In particular, please make sure that you are aware of the financial consequences of replacing your existing policy. If you are in doubt about this, please contact your insurer or insurance intermediary.

Ref. Policy Number ___________

Declaration of Insurer or Intermediary

I hereby declare that in accordance with Regulation 6(1) of the Life Assurance (Provision of Information) Regulations, 2001, ________________ [*] *(the client) has*

Signed: ________________________________

Name of insurer or insurance intermediary

Date: __________

Declaration of Client

I confirm that I have received in writing the information specified in the above declaration.

Signed: ________________

Name of client

Date: ___________

[*] *Insert client name and address.*

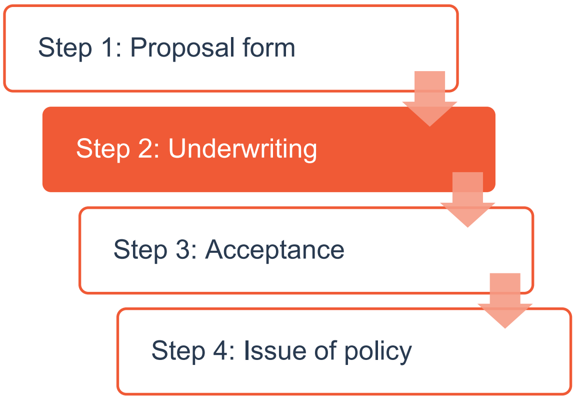
11.2.5.5 Policies *Not* subject to Disclosure Regulations

Some types of policies are **not** covered by the Life Assurance (Provision of Information) Regulations, 2001, and hence are not required to be provided with the Disclosure Notice outlined above; these include:

- Pension policies.
- Policies issued to non-residents.
- Policies where none of the policyholders is an *individual*, for example, a policy issued to a limited company. For example, a Keyperson Insurance policy effected by a company, would *not* be subject to the disclosure regulations.
- Creditor insurance policies effected by lending institutions to cover loans advances, other than housing loans, for example, car loans, short-term personal loans, etc.

Group Mortgage Protection policies, effected by lending institutions to insure housing loan borrowers, are specifically subject to the regulations even though none of the proposers is an individual. Under such policies, disclosure is made to the borrower insured under the policy, as if the borrower had in fact effected an individual Mortgage Protection policy directly with the life assurance company.

11.3 Step 2: Underwriting



When a proposal for a protection policy, such as life assurance or Serious Illness cover, is submitted to a life assurance company, the life company is being asked to take on a **risk**.

Therefore, life and Serious Illness cover are sometimes referred to as **risk benefits.**

The life company must assess whether it can accept this risk and if so, at what terms.

Example

A life company receives a proposal form from a man aged 40, a non-smoker, who wants to insure his own life for €200,000 for 15 years. The premium for the cover for a normal life assured is, say, €40 pm.

If the life company decides to insure this client, there is obviously a risk that he could die after, say, just a year, when the life company would have only received €480 in premiums but yet would have to pay out €200,000. The policy therefore involves a financial risk for the life company.

In calculating the premium to be charged, the life company's actuary estimates what proportion of lives assured are likely to die, or (where Serious Illness cover is required) develop a serious illness during a given 12-month period, i.e., what proportion are likely to give rise to a claim each year.

The life company's actuary advises the directors of the life company on the premium the life company should charge for the various risks it is willing to insure.

Mortality rate

The risk of death during the following year is referred to as the **mortality rate**, i.e. the proportion of lives assured at that age, who are expected to die over the following 12 months.

For example, a mortality rate of, say, 0.5% for a particular age means that the life company expects 0.5% of its lives assured of that age to die over the coming 12 months.

Morbidity rate

The risk of developing a serious illness which would give rise to a serious illness claim, during the following year is referred to as the **morbidity rate**, i.e. the proportion of lives assured at that age who are expected to make a serious illness claim over the following 12 months. For example, a morbidity rate of, say, 0.5% for a particular age means that the life company expects 0.5% of its lives assured of that age to make a serious illness claim in the next 12 months.

The premium charged must allow for these anticipated claims over the term of the policy.

The mortality and morbidity risk for a life assurance company will usually vary by a number of factors including:

Age

Generally, the older the life assured, the higher the mortality or morbidity rate and hence the higher the premium for the same level of cover, as the risk of making a life assurance or serious illness claim in the following year increases with age.

For example, you are more likely to die over the next year at 40, than you are at 30. Premiums for life assurance and Serious Illness cover therefore go up with age.

Gender

Males have a higher risk of dying over a given period than females of the same age. Therefore, males were, in the past, charged a higher premium for the same life cover over the same term, than females of the same age.

In relation to serious illness and Income Protection cover, the position can be reversed; typically, females have a higher risk of claim and have therefore traditionally been charged more, for the same cover and term, than males of a similar age.

However, **life companies cannot use gender as a basis of setting life assurance and Serious Illness cover premiums for new policies issued after 21st December 2012**. Hence for policies issued after that date, the same premiums are charged for men and women of the same age for the same cover over the same term.

Occupation

The risk of developing certain serious illnesses can be increased for certain manual occupations. Also, the risk of death may also be increased for certain occupations, for example, a bomb disposal expert.

Smoker Status

Smokers generally have a much higher risk of dying or developing a serious illness over a given period, than non-smokers of the same age and sex.

11.3.1 Medical Underwriting

When a proposal form for life assurance and/or Serious Illness cover is received by a life company it is first **underwritten**, i.e., the life company decides whether the life assured is:

- An **average** risk (i.e., the same general level of risk allowed for in setting the premium charged for the cover) for someone of that age and smoker status; or

- An **above average** risk with a higher chance of dying or developing a serious illness, than allowed for in setting the premium rates.

The life company underwriter bases his or her decision using a number of sources of information:

- **Answers given by the life assured in the proposal form**.

- **In some cases, the underwriter may seek a medical report from the life assured's own doctor**.

  This is usually referred to as a private medical attendant's report, or PMA or PMAR for short. If the life assured had some specialist treatment in the past, the underwriter might seek a report and medical records from the consultant and/or hospital attended by the life assured.

- **Any information the life company may already have on that life assured** if the individual is already insured by that life company.

- **Answers and information given in additional questionnaires**, which the life company may send to certain proposed lives assured during the underwriting process, where details of some specific potentially hazardous sport, hobby, or occupation has been disclosed on the proposal form.

  For example, a life assured discloses on the proposal form that they fly a small light plane as a hobby. The life company may send the life assured an *aviation questionnaire*, seeking more details, for example, how many hours flying per year, the type of plane he/she flies, flying experience and qualifications, etc.

- For large sums assured or where a serious medical problem has been disclosed, **the life company may ask the life assured to undergo an independent medical examination at the life company's expense**. The results of this examination and associated tests will be available to the underwriter.

- **Consultation with the life company's Chief Medical Officer (CMO)**. A life company's CMO will be an experienced medical consultant, who may review the results of a medical examination, PMA, etc. on a proposed life assured, to advise the underwriter on the degree of extra risk, if any, involved in insuring that life.

Apart from the proposal form, life companies do not necessarily seek all of the above information for each proposal for a protection policy.

Life companies usually have a scale of cover below which they do not normally seek an independent medical examination unless there are indications that the life assured has a reduced life expectancy; this limit is usually referred to as the **non-medical limit.**

The non-medical limit and the various other limits at which different information is usually sought are sometimes collectively referred to as **underwriting limits.** These limits typically:

- Reduce with the age of the life assured.

- Increase with the amount of cover sought (including cover already held with that life company).

- Can vary according to the type of cover required so that lower limits usually apply to Serious Illness cover than for life cover of the same amount.

Typically, these limits would be imposed by reference to the total amount of cover the life assured has with that life company already and the additional cover now sought, rather than just by reference to the amount of new cover now being sought. The life company has to consider its total exposure to any one life assured.

Note that a life company always reserves the right to seek a medical examination, even for cover below the non-medical limit; for example, where answers on the proposal forms indicate an adverse medical history, such as high blood pressure, etc.

The purpose of medical underwriting is not to trip up the consumer seeking life or Serious Illness cover, but to ensure that everyone insured with the life company is charged a fair premium relative to their *risk* of making a claim.

11.3.2 Different Risk Classes

In some cases, rather than having just one set of premium rates and then imposing individual loadings on non-standard or above average risk lives assured, a life company may have different broad classes of premium rates.

For example, it might, for a particular product, have class 1, 2, 3, etc, rates, with the best lowest risk lives getting class 1 contribution rates, class 2 rates applying to the next group of higher risk lives and class 3 applying to the group of highest risk lives. In Income Protection, for example, contribution rates are usually banded into five risk categories, 1 to 5, according to the nature of the insured’s occupation, with low-risk desk jobs falling into class 1 but the highest risk manual occupations, for example, window cleaner, falling into class 5.

Sometimes terms such as **preferred** and **standard** may be used to denote lower risk and normal risk lives.

11.3.3 Discrimination

Under the Equal Status Act, a life company, like any other financial services provider, cannot discriminate (in terms of setting contributions or benefits, underwriting terms, etc) between different policyholders on any of the following grounds:

- Gender
- Marital status
- Family status
- Sexual orientation
- Religious belief
- Age
- Disability
- Membership of the travelling community

However, life companies can discriminate in terms of setting premiums or benefits, underwriting terms, etc. on any of the above grounds (other than gender with effect from 21st December 2012), where the discrimination involved is based on:

- Actuarial or statistical data obtained from a reliable source for example, mortality tables.

  OR

- Other relevant underwriting or commercial factors.

  AND

- The discrimination is reasonable having regard to the data or other relevant factors.

So, life companies can charge different premiums by age (older lives are charged higher premiums for the same benefits than younger lives) on the basis that they have reliable statistical information and data showing that the risk of a life assurance or serious illness claim varies by age.

11.3.4 Code of Practice for Underwriting Mortgage Protection for Cancer Survivors

The Code of Practice for Underwriting Mortgage Protection for Cancer Survivors was introduced because some people with a history of cancer had faced difficulties in getting mortgage protection as a result of their medical history. Its aim is to improve access and fairness for consumers who have survived cancer and want to buy mortgage protection.

The Code of Practice has been adopted by the members of Insurance Ireland, the representative body for the insurance industry in Ireland, that offer mortgage protection. It is also open to non-members to sign up to the Code. The Code sets out the principles and standards that insurers will follow when underwriting mortgage protection for cancer survivors. It was introduced on 6th December 2023.

Insurers will disregard any disclosed cancer diagnosis where:

- The application is for Mortgage Protection (decreasing term) life cover in connection with a mortgage on a principal private residence,
- The insurance cover sought is for €500,000 or less, and
- Treatment for cancer ended more than seven years prior to the application, or more than five years prior if the applicant was under 18 at the time of diagnosis. Treatment has ended means being in complete remission and active treatment having ended.

Example #1

Hakim is 43 and is applying for a Mortgage Protection policy. He has a history of skin cancer and no other health issues. It's more than seven years since he received cancer treatment. His last treatment ended 7 years and one month ago.

Hakim is buying a home where he will live (it will be his principal private residence) and needs a Mortgage Protection policy of €500,000 for his mortgage loan. Before this Code was implemented, Hakim's policy would have been subject to normal underwriting in relation to his history of cancer. This might have led to an additional charge (a premium loading) being added to Hakim's policy which would have increased the amount of total monthly premiums for the policy.

Hakim applies for a Mortgage Protection life cover policy of €500,000. As part of the standard application process, Hakim will be asked when his cancer treatment ended. Once it is confirmed this that treatment ended seven years ago or more, some additional questions will be asked to establish Hakim's eligibility to avail of the Code of Practice (for instance, whether or not the home will be his principal private residence).

Once eligibility has been established, Hakim's policy will not be underwritten for cancer and he will be offered cover at standard rates, in this regard.

Example #2

Aoife is 36 and is applying for a Mortgage Protection policy. She has a history of breast cancer and had surgery nine years ago, followed by chemotherapy, which ended eight years ago.

Unfortunately, Aoife had a recurrence of cancer six years ago, requiring further treatment. Apart from this, she has had no other medical issues.

Aoife applies for a Mortgage Protection policy of €450,000. This is related to a mortgage that Aoife is taking out for the same amount, for a home that will be her principal private residence.

As Aoife's most recent cancer diagnosis and treatment ended less than seven years ago, she does not qualify under the Code of Practice and normal underwriting will apply in the assessment of her application.

Only her cancer diagnosis that occurred less than seven years ago will be taken into account in the underwriting of her application.

11.3.5 Genetic Tests

The Disability Act, 2005 provides that a person cann**ot** process genetic data in relation to a life assurance policy. This means that a life company cannot:

- Ask a proposer whether he or she has taken a genetic test.

  OR

- Take account of the results of a genetic test into account for the purposes of underwriting, whether the result was positive or negative.

For example, a life assured cannot be asked on a proposal form if they have undergone a genetic test or the results of such a test.

11.3.6 Financial Underwriting

A life company would be unlikely to offer to insure an individual for €1,000,000, where that individual's income is only, say, €25,000 pa. Why would an individual on that income require €1,000,000 worth of cover? Is the individual contemplating suicide?

The term **financial underwriting** refers to the process to determine whether the amount of cover sought is justified by the financial circumstances of the proposer, for example, is there a moral risk involved for the life company, in taking on the sum to be assured?

Financial underwriting is particularly important in the case of:

- *Life of another* policies (i.e., where an individual is affecting cover on the life of another individual.

  AND

- *Serious Illness cover*, where the individual does not have to die to be able to claim on the policy.

Life companies may have **financial underwriting limits**; i.e., limits of cover above which they will seek financial evidence that the cover requested is needed and warranted by the proposer's financial circumstances. Financial evidence which may be sought could include:

- Evidence of earnings and/or assets.

- A report from the proposer's accountant and/or solicitor confirming the reason for the level of cover sought.

11.3.7 The Underwriting Decision

Following the underwriting process, there are a number of main possible outcomes depending on the life company underwriter's decision:

Accept at ordinary rates	Agree to issue the policy at its normal premium rates. Sometimes referred to as O/R. Over 95% of proposals will fall into this category.
Offer cover at a higher premium	Reject the proposal but offer to issue the policy at an increased premium to reflect a higher risk of a claim. The premiium is said to be **'loaded'**.
Offer a reduced sum assured	Reject the proposal but offer to issue the policy at the normal premium subject to imposing a debt or reduction on the sum assured.
Postpone	Reject the proposal because the risk is too high, but offer to reconsider the proposal after a period of time, for example, after the life assured underwent a serious operation which he or she is about to have.
Decline	Rject the propoal outright, because the risk of a claim is tadjudged to be too high or uncertain to insure.

11.3.8 Savings and Investment Policies

In the case of savings and investment policies with no material life cover over and above the encashment value of the policy at the date of death, such policies are usually automatically ‘accepted’ by the life company and are not generally subject to medical or financial underwriting.

They effectively go straight to policy issue stage.

11.4 Pre-contractual Duties of Consumer and Insurer

The consumer must answer all questions posed by the insurer honestly and with reasonable care. The consumer’s pre-contractual duty of disclosure is restricted to answering questions asked by the insurer, and the consumer is not under any duty to volunteer any information over and above that required by these questions. The questions that the insurer asks must be drafted in plain and intelligible language. Where there is an ambiguity or a doubt about the meaning of a question, the interpretation most favourable to the consumer will prevail.

The insurer must inform the consumer before a contract of insurance is entered into, of their pre-contractual duty of disclosure. An insurer is deemed to have waived any further duty of disclosure of the consumer where it fails to investigate an unanswered or obviously incomplete answer to a question.

Example

Mr Smith suffers from angina and is currently on medication for this ailment.

Mr Smith is now proposing for life assurance. The application that Mr Smith is required to complete includes the following question:

Have you ever had any of the following: Disease or disorder of the heart (including valves) or circulatory system, heart attack, angina, cardiomyopathy, disease of the arteries or peripheral vascular disease?

The fact that he has a history of angina means that Mr Smith must answer this question honestly as a consequence of his pre-contractual duty of disclosure.

11.4.1 Misrepresentation

The term **misrepresentation** means that:

The consumer has not complied with the duty to answer all questions posed by the insurer honestly and with reasonable care, when proposing for life or Serious Illness cover to a life company.

If misrepresentation occurs, the insurer is entitled to apply remedies that are proportionate to the effects of any misrepresentation on the interests of the insurer and the consumer depending on whether the misrepresentation was:

(a) innocent,

(b) negligent, or

(c) fraudulent.

Where a claim is made under a contract of insurance and where the consumer has answered questions honestly and with reasonable care, but where an answer involves an innocent misrepresentation, the insurer is required to pay the claim made and will not be entitled to avoid the contract on the ground that there was a misrepresentation.

Where a claim is made but where an answer involves a negligent misrepresentation (that is, one that was not fraudulent), the remedy available to the insurer must reflect what the insurer would have done had it been aware of the full facts. If the insurer would not have entered into the insurance contract on any terms, the insurer may avoid the contract and refuse all claims, but must return the premiums paid. If the insurer would have entered into the contract, but would have charged a higher premium, the insurer may reduce proportionately the amount to be paid on a claim.

Fraudulent misrepresentation means a misrepresentation that is false or misleading and which the consumer either:

(a) knows to be false or misleading, or

(b) consciously disregards whether it is false.

Where a claim is made where an answer by the consumer involves a fraudulent misrepresentation, the insurer shall be entitled to avoid the contract of insurance.

Example

Mr Smith is now proposing for life assurance.

He has no known history of heart trouble and answers all the questions on the proposal form correctly to the best of his knowledge at that time.

However, one year after the policy has been issued, he developed angina and is found to have a 90% blockage in two arteries.

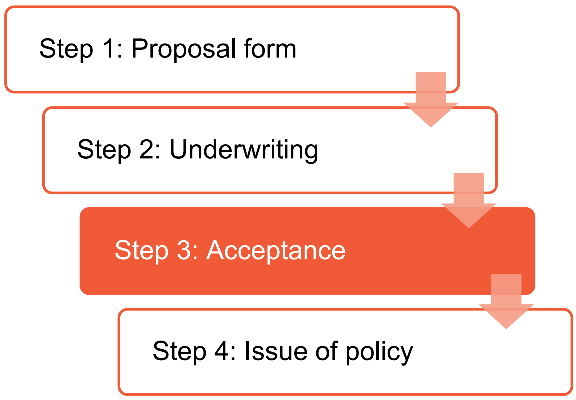
Cleary this condition would have been present at the time Mr Smith proposed for the policy one year earlier, but because Mr Smith was not aware of having such a problem at that time, this would not be regarded as misrepresentation.

The duty of disclosure is not necessarily only a fact related to the individual's medical circumstances.

The duty of disclosure also extends to, for example, specific questions that the insurer poses relating to the individual's hobbies, activities, and any plans to travel abroad to dangerous parts, i.e., any fact that could influence the life company in its decision on the terms, if any, on which the proposal may be accepted or declined.

11.5 Step 3: Acceptance

Where the life company is prepared to accept the proposal at the company's normal premium rates, the policy goes to the final step – i.e., issue the policy and seek the payment of the first premium.



The **Letter of Acceptance** is really saying that the life company is refusing the proposer's first offer to be insured at its normal terms but is making an alternative or *counteroffer* to provide the cover requested at different terms.

Where the life company rejects the initial proposal but is prepared to accept the proposal at different terms, the life company will send a Letter of Acceptance to the proposer, setting out the alternative terms at which the life company is prepared to accept the proposal, for example, subject to an extra premium.

It is therefore up to the proposer to either accept or reject this alternative offer from the life company. If he or she wants to take up this alternative offer, they must sign the Letter of Acceptance to this effect and return it to the life company.

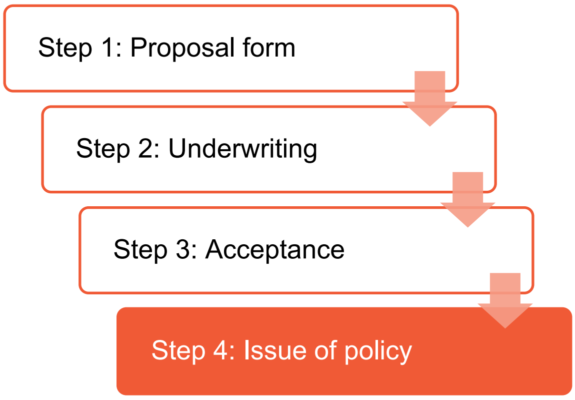
11.6 Step 4: Issue of Policy

Under the Central Bank's Consumer Protection Code, a life assurance company must:

> *"...issue policy documents, within five business days of all relevant information being provided by the consumer and cover being underwritten, to any consumer to whom it has sold its insurance policy directly or to any insurance intermediary that has sold its insurance policy.*
>
> *An insurance intermediary must, within five business days of receiving the policy documents from an insurance undertaking, provide them to the consumer."*

Separately, under the Consumer Insurance Contracts Act 2019, the insurer must, where relevant to the particular contract, provide the policy owner, with a copy of the completed application or proposal form. This must occur within a reasonable time after concluding the contract.

11.6.1 Paying the First Premium



At this stage, agreement has been reached between the proposer and the life company to issue the policy at agreed terms.

However, **the policy does not legally come into force until the first premium is paid**, i.e., the *consideration* for the legal contract. Without consideration, i.e., payment of the premium, the policy is not legally enforceable.

The final step, therefore, is for the life company to collect the first premium from the proposer, where the proposer has not already paid the first premium to the life company.

If the proposer had already signed a direct debit as part of the proposal form, then the life company will, at this stage, send the direct debit to his bank for payment.

In other cases, the proposer may be paying by cheque or payroll deduction. In any event, the life company will proceed to make arrangements to collect the first premium.

Most life companies will **issue** the policy document on the assumption that the first premium will be paid or where the premium has actually already been paid.

An important condition in most policies is that the policy does not legally come into force until the first premium is paid; however, some life companies may start the cover from the date of acceptance of the proposal even if the first premium has not been paid by that date.

Therefore, the issue to the proposer of the policy document does not necessarily mean that the policy and cover is in force at that time. The policy does not come into force and hence the life assured is not covered until the proposer pays the first premium.

However, some life companies may offer *free accidental death cover* during the period when the proposal is being underwritten.

In such a case if the life assured dies by accident before the policy is issued, as a result of a car crash for example, the life company might pay out the proposed sum assured (up to a certain limit) on a discretionary or *ex gratia* basis, i.e., the life company is not legally bound to make the payment but may decide to do so anyway.

Once the policy is issued and the first premium paid, the proposer becomes the **policyholder** or legal owner of the policy (sometimes referred to as the **grantee** of the policy).

11.6.2 Policy Document

The policy document is written evidence of the legal contract between the life company and the policyholder. It usually consists of a Schedule attached to a set of standard *policy conditions*.

The Schedule will usually show the name and date of birth of the policyholder and life assured along with details of the policy, such as the sum assured and the premium payable and the frequency and method of payment.

The policy conditions will set out:

Terms and conditions
- For example, that the policyholder agrees to pay the premiums, the circumstances in which the life company agrees to pay out benefits, etc.

Benefits
- The benefit payable on the happening of insured events, for example, on the death of the life assured

Exclusions
- The circumstances where benefits are not payable on the happening of an insured event

11.6.3 Disclosure Notice and Cooling-Off Period

When the policy is issued, the client will also receive two other items along with the policy document:

Specific Disclosure Notice

A policy **specific** notice where a generic notice was given just before the proposal form was signed

Cooling-off Notice

Life companies are required by law to allow proposers for individual life assurance policies 30 days from the date of posting of the policy to them, to cancel the policy and receive a full refund of any premiums paid. This is often referred to as a **cooling-off period**.

In the case of unit linked investment bonds, the right to a refund during the cooling off period is qualified; the life company is entitled to deduct any investment losses on the unit funds in which the policy was invested, during the period between issue of the policy and the policyholder's deciding to cancel the policy, within the 30-day cooling-off period.

Example

John invests €50,000 in a unit linked investment bond in a managed fund. John buys units in the fund at a price of €1.50. A week later, within the 30-day cooling-off period, John decides to exercise his right to cancel the policy.

By that time, the unit price had fallen to €1.40.

His maximum entitlement to a refund if he exercises the cooling-off right now is limited to:

$$€50,000 \times €1.40/€1.50 = €46,667$$

i.e., he must suffer the investment loss (but not policy charges and expenses) incurred by the investment of the funds invested, over the period the policy was actually in force.

Some policies are **not** entitled to this statutory 30-day cooling-off period, including:

- Term Assurances effected for a term of six months' duration or less.
- Contracts of insurance where none of the proposers or policyholders is an individual.

  For example pension policies issued to trustees of occupational pension schemes, such as executive pension plans, do not qualify for the 30-day cooling-off period, as the proposer is a trustee and not an individual. Company owned policies, for example, keyperson policies, also do not qualify for the cancellation right.
- Contracts of creditor insurance effected for the purpose of insuring the repayment of a loan and where it is intended that such a contract will be assigned or deposited with the lender.
- Separately under the Consumer Insurance Contracts Act 2019, these policies above which are not entitled to the statutory 30 day cooling off period are, with effect from 1st September 2021, entitled to a separate 14 day cooling off period.

11.6.4 Policies Which Don't Proceed

In a small number of cases, on issue of the policy document, the proposer changes his or her mind and decides not to pay the first premium; for example, the life company may send the direct debit to the proposer's bank, but it is returned or *bounced*, i.e., not paid by the bank, as the proposer has cancelled the debit or there are insufficient funds in the proposer's bank account.

Where the first premium is not paid, even though the policy document has been issued, the policy is then void and this is sometimes referred to as **cancelled from inception (CFI)** or **not taken up (NTU)**. This is a different situation to where a policyholder pays the first premium but then exercises his or her cooling off right within the first 30 days, and gets a full refund of the premium paid.

In the case of returned direct debits the life company may try a second time, after notifying the proposer that the first debit was returned.

11.7 Reinsurance

Life assurance companies frequently lay off or **cede** part of the protection risks they take on, by reinsuring part of the risk with a specialist insurance company called a **reinsurance** company.

Life companies do this to protect themselves against the financial impact of a potentially large number of claims all happening within a short period of time or a small number of very large claims. By reinsuring part of their risks, life companies hope to reduce the volatility of death and serious illness claims.

Example

A life company receives a proposal form from a man aged 40, a non-smoker, who wants to insure his life for €750,000 for 15 years.

If the life company takes this risk on it would have to pay out €750,000, if the life assured died within this 15-year period; the life assured could, for example, die in an accident within a month of issuing the policy.

Rather than carry all of this risk itself, the life company might decide to reinsure, say, €400,000 of this risk with a reinsurance company, to which it must pay a reinsurance premium.

If the life assured dies, the life company will pay out €750,000 to the beneficiaries but will collect €400,000 from the reinsurance company and so its net outflow is just €350,000, rather than €750,000 which would have been the case if the life company hadn't used reinsurance.

Of course, in return for this the life company has:

- Paid a premium to the reinsurance company; and has also,
- Ceded away part of the anticipated mortality profits (i.e., if death claims turn out to be less than expected).

So, the life company swaps potential loss of profits on part of the policy in return for reduced volatility of claims.

Reinsurance is sometimes referred to as *insurance for insurance companies*.

Where a life company is using reinsurance, the reinsurer may have a significant influence and power over the life company's underwriting decisions for large sums assured as, after all, it is the reinsurance company that will be carrying a significant part of the risk.

For example, if a life company with a retention limit of €350,000 receives a proposal and issues a policy for a sum assured of €1,000,000, it is the reinsurance company which will carry the greater part, in this case 2/3 of the risk.

There are two main types of reinsurance:

- **Quota share**; and
- **Surplus or excess**.

11.7.1.1 Quota Share Reinsurance

The life company reinsures a specified amount, for example, 33%, of each and every risk. So, in the event of any claim, the life company is only at risk for, say, 67% of the claim.

Example

A life company has a quota share reinsurance agreement with a reinsurance company, under which it reinsures 33% of each risk.

Joe is insured for €90,000 with the life company. If Joe dies, the life company will pay out €90,000 but is only at risk for €60,000 as it will reclaim €30,000 on its reinsurance.

11.7.1.2 Surplus or Excess Reinsurance

In this case the life company reinsures the excess or surplus of the risk over a specified amount, called the life company's *retention limit*.

Example

A life company has an excess reinsurance agreement with a reinsurance company, under which it reinsures all of the risk above the life company's retention limit of €200,000 on each life assured.

Joe is insured for €340,000 with the life company. The life company holds €200,000 of this risk itself and reinsures the excess or surplus over this amount, i.e., €340,000 – €200,000, i.e., €140,000 with a reinsurance company.

If Joe dies, the life company will pay out €340,000 but is only at risk for €200,000 as it will reclaim €140,000 on its reinsurance.

The retention limit will vary from life company to life company and will usually take account of all cover held by that life assured with that life company. Newer, less capitalised, life companies will tend to have lower retention limits than longer well established and financially very strong life companies.

Some life companies may use a combination of quota share and excess reinsurance.

11.8 Annual Statement of Value

Life companies who issue policies which are subject to the Disclosure Notice, and which acquire a surrender or cash value (for example, savings plans and investment bonds) must issue an annual statement on an ongoing basis to such policyholders showing:

- The current premium payable if a regular contribution is payable;
- The current surrender or maturity value; and,
- Such further information *as the insurer considers appropriate*.

However, this disclosure requirement is extended by the Central Bank's Consumer Protection Code which requires a life company in respect of any investment product (which includes unit linked savings plans and unit linked bonds, and Tracker Bonds) to provide annually to a consumer a statement in respect of the previous 12-month period, which includes:

- The opening balance or value;
- All additions including additional amounts invested;
- All withdrawals;

- The total sum invested;
- The number of units held;
- All interest;
- All charges and deductions affecting the investment product including any charges associated with the management, sale, set up and ongoing administration of the investment product; and,
- The closing balance or statement of the value of the investment.

Review

Now consider the main teaching points, which were introduced in this Chapter. They are listed below. Tick each one as you go through them.

- [ ] The main elements of forming a valid life assurance contract
- [ ] The four steps involved in taking out a policy with a life company
- [ ] The consumer’s pre-contractual duty of disclosure
- [ ] Remedies for the three types of misrepresentation
- [ ] What underwriting is and why a life company underwrites proposals submitted to it
- [ ] The difference between medical and financial underwriting
- [ ] The benefits of Reinsurance for a life company, and the different types of reinsurance.
- [ ] Annual statement of value

Sample Questions

The answers to these questions can be found in your Study Hub.

1. Which term is often used to describe the legal owner of a life assurance policy?

   A. Administrator.
   B. Trustee.
   C. Executor.
   D. Grantee.

2. When a life assurance company issues a Disclosure Notice to the client at the same time as it issues the policy, the notice is referred to as which type of notice?

   A. Generic.
   B. Conditional.
   C. Final.
   D. Specific.

3. Why do life companies medically underwrite proposals for life assurance?

   A. To prevent all but healthy lives obtaining cover with the life company.
   B. To enable premium rates to be determined according to gender.
   C. To ensure that everyone seeking cover pays a fair premium relative to their risk of claiming.
   D. To meet the requirements of the Life Assurance (Provision of Information) Regulations, 2001.

4. Patricia has invested €50,000 in a unit linked bond investing in an international equity fund. Within the cooling off period Patricia exercised her cooling off right to cancel the policy. Between issue of the policy and when she exercised her cooling off right, the international equity fund unit price fell by 10%.

   What is the MAXIMUM amount Patricia is legally entitled to get as a refund on cancellation of the policy?

   A. €40,000
   B. €45,000
   C. €50,000
   D. €55,000

12

Paying Out Benefits

This Chapter examines the process by which a life assurance company pays out policy claims arising on events such as death, serious illness and encashment/maturity, including the information sought to validate a claim.

Learning Outcomes – after studying this chapter you should be able to:
explain how a benefit payable under a life assurance policy can be claimed by the policyholder(s) or their dependants in the case of a death claim; and
describe the Central Bank's Consumer Protection Code obligations with regard to processing claims.

Chapter weightings	Number of questions which may appear		
In the exam, questions are taken from each Chapter based on the following approximate chart:	Chapter	Minimum	Maximum
	12	2	4

12.1 Introduction

A life assurance policy is a promise *to pay* on the happening of certain insured events specified in the policy; for example, a promise to pay a lump sum on the death of or on the diagnosis of a serious illness by the life assured.

At some stage, therefore, the benefits from the policy will become payable to the person entitled to them, i.e., the **beneficiary** of the policy.

The term **claim** is used to refer to the beneficiary of the policy seeking payment of benefits due from the policy following the happening of an insured event, e.g. death of the life assured.

12.2 Events Giving Rise to a Claim

Depending on the benefits provided by the policy, there are a number of different events which can give rise to a claim on a policy:

Death	Maturity	Illness	Encashment

- Death of the life assured covered by the policy, where a death benefit is payable on that life assured’s death.
- The policy reaches its predetermined maturity date, for example, a Tracker Bond matures.
- Diagnosis of a serious illness by the life assured, under a policy which provides cover against serious illness, for example, IP, or Serious Illness cover.
- Encashment, i.e., client decides to encash the policy, either in part or fully.

12.3 Making a Claim

There may be two separate types of claims:

- An encashment (partial or total) or Serious Illness claim.
- A death benefit claim.

12.3.1 Encashment/Serious Illness Claim

In the case of an encashment or serious illness claim, the person(s) entitled to claim the proceeds depends on how the policy was arranged:

Type of policy	Encashment/serious illness benefit payable to
Own life, not under trust and not assigned.	The policyholder.
Life of another, not under trust and not assigned.	The policyholder.
Joint life first death, dual lives, not under trust and not assigned.	The surviving policyholder(s).
Joint life last survivor, not under trust and not assigned.	The surviving policyholder(s).
Assigned.	The assignee, i.e., person to whom the policy has been legally assigned.
Under trust.	The nominated trustees; however, frequently the Declaration of Trust will specify the person who originally took out the policy as the beneficiary of a payment made *otherwise* than on the death of the life assured, for example, the encashment value.

12.3.2 Death Claim

In the case of a death claim, the person(s) entitled to claim the proceeds depends on how the policy was arranged:

Type of policy	Death benefit payable to
Own life, not under trust and not assigned.	The deceased's legal personal representatives.
Life of another, not under trust and not assigned.	The policyholder.
Joint life first death, dual lives, on death of first to die, not under trust and not assigned.	The surviving policyholder.
Joint life last survivor, on death of last to die, not under trust and not assigned.	The legal personal representatives of the last of the lives assured to die.
Assigned.	The assignee, i.e., person to whom the policy has been assigned.
Under trust.	The nominated trustees.

12.3.3 Requirements

In making a claim on a policy, the claimant will usually be required to:

- **Complete and sign a claim form**. These are pre-printed by the life company and available from them.

- **Prove legal entitlement to claim under the policy**; that the claimant is the legal owner of the policy or legally entitled to claim under it.

- **Provide a copy of Deed of Assignment if policy has been assigned, and the assignment not released**. A Deed of Assignment is a document by which a legal interest in the policy is conveyed to another party, usually as security for a loan. Where the loan is paid off, the assignment is released by the lender and the policyholder regains full entitlement to the policy proceeds.

- **Provide proof that the insured event has happened**; for example, death certificate or, in the case of a serious illness claim, medical confirmation and evidence of the occurrence of the serious illness.

- **Return the original policy document to the life company**. This is the evidence of the contract between the policyholder and the life company.

Where the policy is being fully encashed or terminated, the life company will retain and cancel the policy.

Where there is a partial encashment and the policy continues, the life company will usually endorse the policy document before returning it to the policyholder, i.e., place a statement on the policy face to confirm the nature and amount of the benefit withdrawn from the policy and the remaining benefit of the policy. However, in some cases, the life company will not necessarily require the original policy document to make a partial encashment.

It is not unusual to find that a client may have lost the original policy document. In this case the life company may require the beneficiary to complete and sign a **Lost Policy Declaration,** which usually has to be witnessed by a Peace Commissioner or Commissioner for Oaths.

12.4 Paying Out a Claim

The life company will decide, following the claims process outlined above, whether it is *admitting*, i.e., agreeing to pay out a claim, or *declining* or *rejecting* the claim on the policy. The rejection of a claim is sometimes referred to as a *declinature*. In all cases the life company must handle the claim promptly and fairly.

A life company must satisfy itself on a number of issues in relation to a claim before admitting a claim:

Proof that the insured event has happened

In the case of a death claim, the life company will want to see sight of the Death Certificate for two reasons:

- To establish that the life assured has died.

- To establish the cause of death.

Checks will also be made that the claim is not subject to an exclusion in the policy document, for example, death claims as a result of suicide of the life assured within the first 12 months of a policy (24 months in some policies) are usually subject to an exclusion in the policy terms and conditions.

In the case of a serious illness claim, medical evidence of the diagnosis of the illness will be sought and that such illness fully meets the definition of the illness set out in the policy document.

Proof of Life Assured's age

Where the age of the life assured was not verified (referred to as **age not admitted**) at the time the policy was issued or since, the life company may seek a birth certificate or other evidence of age of the life assured, before paying a claim.

The term **age admitted** means that the life company has verified the life assured's age, for example, had sight of a copy of a birth certificate or passport.

If the age of the life assured transpires to be older than that stated on the policy schedule, the benefits may be reduced by the life company to the level that would have applied for the contribution paid, based on the correct age of the life assured, at the time the policy was issued.

Deliberate non-disclosure of known relevant information?

In the case of a protection policy, the life company may check that there was no deliberate non-disclosure of relevant information known to the proposer/life assured before the policy was issued, which would invalidate the policy; for example, did the life assured die from some illness that they already knew they had at the time the policy was taken out, but which was not declared by them to the life company on the proposal form or at a medical examination?

In the case of a death claim, the death certificate will be examined to see what the stated cause of death was.

In certain cases, the life company might seek a report from the deceased's doctor and hospital records to accurately establish the cause of death and when the illness developed.

Proof of correct legal title of those claiming the benefit

The life company must ensure that it pays to the right person; if it accidentally paid to the wrong person, it would then have to pay out again to the correct legal beneficiary. Hence it must make certain that it does pay the benefits to the right person.

In the case of a death claim under an own life policy, not assigned or arranged under trust, where the policyholder dies legal title to the policy benefits passes to their legal personal representatives. In such a case, the life company will therefore seek sight of the High Court's **Grant of Probate** (where the deceased died leaving a valid Will) or **Letters of Administration** (where the deceased died without leaving a valid Will), before paying out to the policyholder's legal personal representatives.

Once the life company pays to the person legally entitled to the proceeds, it has completed the contract and is under no obligation to see to the correct distribution of the policy proceeds.

12.5 Ongoing Claims Processing

The process outlined above implied a once off claims process, for example:

- A life assured dies and the beneficiary makes a claim on the policy for the death sum assured.
- A policyholder makes a claim on their own Term Assurance policy for accelerated Serious Illness cover, following a heart attack.

However, in the case of Income Protection and hospital cash, the benefit is payable at regular intervals only if the claimant continues to meet the conditions of benefit payment (for example, in the case of Income Protection, the insured is unable to work due to sickness or disability and is suffering a loss of income), and hence there is an ongoing claims process to determine continued entitlement to such benefit payments.

12.6 Consumer Protection Code and Claims

The Central Bank's Consumer Protection Code imposes several obligations on life assurance companies and insurance intermediaries in relation to the processing of claims on policies.

12.6.1 Verifying the Validity of a Claim

The life company is required to *'endeavour to verify the validity of a claim received from a claimant prior to making a decision on its outcome.'*

This requirement, in relation to claims on protection policies, is relevant to claims arising from sickness or injury/disability where an element of subjective judgement can sometimes arise in assessing whether a claim is or is not valid, within the terms of the policy.

12.6.2 Claims Procedures

A life company or insurance intermediary must have in place written procedures for the *effective and proper handling of claims*.

At a minimum, the procedures must provide that:

- Where a claim form is required to be completed, it must be issued to the claimant within **five** business days of receiving notice of a claim.
- Assistance be provided to the client in the process of making a claim, including, where relevant, alerting the client to policy terms and conditions that may be of benefit to them.
- A record of all conversations with the claimant in relation to the claim is maintained.
- While the claim is ongoing, provide the claimant with updates of any developments affecting the outcome of the claim within **10** business days of the development. When additional documentation or clarification is required from the claimant, the claimant must be advised of this as soon as required and, if necessary, issued with a reminder on paper or on another durable medium.[13]

12.6.3 Transmission of Claims Documentation to Life Company

An insurance intermediary who assists a consumer in making a claim on a policy must, on receipt of the completed claims documentation from the consumer, transmit such documentation to the life company within **one** business day.

12.6.4 Payment of a Claim

The life company or insurance intermediary dealing with the consumer must, within **10** business days of making a decision in respect of a claim, inform the claimant in writing, of the outcome of the investigation explaining the decision in relation to the claim. When admitting a claim, the life company must ensure that the following conditions have been satisfied:

- The insured event has been proven or accepted by the life company.
- All specified documentation has been received by the life company from the claimant.

[13] Durable medium is defined in the Consumer Protection Code as: 'any instrument that enables a recipient to store information addressed personally to the recipient in a way that renders it accessible for future reference for a period of time adequate for the purposes of the information and which allows the unchanged reproduction of the information stored'. Examples are PDF files.

- The entitlement of the claimant to receive payment under the policy has been established.

Where a claimant has agreed to accept the offer made by the life company, the life company must discharge the claim within **10** business days from the date the claimant has agreed to accept the offer.

If the claim is paid to an assignee of the policy rather than to the consumer who is the policyholder, for example, encashment of a policy assigned to the bank as security for a loan, the life company must advise the consumer in writing of the time that claim was paid and the amount of the claim.

12.6.5 Declined Claim

If the life company decides to **decline** the claim, the reasons for that decision must be provided to the claimant in writing. The consumer must also be informed of:

- Any internal appeals mechanisms available to the consumer; and,

- His or her right to refer a complaint about the declined claim to the Financial Services Ombudsman.

12.7 Reporting Benefit Payments to Revenue

Life assurance companies are required to make an annual electronic return to the Revenue Commissioners of certain benefit payments made to certain policyholders during a year, no later than 31st March following the end of that year.

In general, the reporting requirement applies only to investment/savings benefit payments on policies other than pension policies. Therefore, the obligation to make a return to Revenue will mainly relate to savings, investment and Unit Linked Whole of Life policies held by residents of the State.

The benefit payment to be returned does **not** include any payment made **solely** by reason of death or disability. So, for example, in the case of a death benefit payment under a unit linked protection policy, the benefit payment to be returned is the surrender value immediately before death.

Review

Now consider the main teaching points, which were introduced in this Chapter. They are listed below. Tick each one as you go through them.

- The various events which can give rise to a claim under a policy ☐
- Who is entitled to claim under a policy ☐
- The main steps a life company takes when processing a claim under a policy ☐
- The main provisions of the Central Bank Consumer Protection Code in relation to the processing of claims under life assurance policies ☐
- Reporting benefit payments to Revenue ☐

Sample Questions

The answers to these questions can be found in your Study Hub.

1. A life company is NOT required to make a Revenue return of the benefits paid out under which one of the following policy types?

   A. PRSA.
   B. Tracker bond.
   C. Unit linked bond.
   D. Unit linked savings plan.

2. Legal ownership of a policy is changed by the execution of a:

   A. Deed of appointment.
   B. Deed of substitution.
   C. Notice of interest.
   D. Deed of assignment.

3. Jim is married and has a Term Assurance policy on his own life which has not been assigned or written under trust. Jim’s Will leaves the policy proceeds to his daughter, Emily. If Jim dies, who must make a claim on the policy?

   A. His spouse.
   B. Emily.
   C. His legal personal representatives.
   D. Jim's nearest living relative.

4. Maureen has notified a life assurance company that her husband, who had a policy with the life company, has died. Under the Consumer Protection Code, the life company must issue a claim form to her within what MAXIMUM number of business days?

   A. 3
   B. 5
   C. 7
   D. 14

13

Financial Maths

This Chapter explains the concept of the time value of money, and in particular how to calculate the accumulated and discounted value of a sum of money over a specified period of years.

It also explains how inflation and deflation can change the real value of life assurance and Serious Illness cover.

This Chapter brings you through easy-to-understand practical examples of how these calculations are done.

Learning Outcomes – after studying this chapter you should be able to:
explain the concept of the **time value of money**;
calculate the rate of inflation or deflation over a particular period;
accumulate or discount a capital sum over a particular period, using supplied tables based on specific rates of interest; and
explain what each of the following terms are, and how they can be used to compare financial products: - Reduction in yield (RIY). - APR. - AER.

Chapter weightings	**Number of questions which may appear**		
In the exam, questions are taken from each Chapter based on the following approximate chart:	Chapter	Minimum	Maximum
	13	3	5

13.1 Understanding the Concept of the Time Value of Money

When advising a client in relation to personal financial planning, accumulating funds for the future is a constant theme, for example:

- The appropriate lump sum required to replace lost earned income in the event of death or disability.
- Accumulating savings to grow into a capital sum in the future.
- Investing a lump sum to grow and be drawn on, in the future.

It is important to understand that the value of a €1 changes over time:

- A €1 invested today will accumulate with interest over a period of time to an amount greater than €1; this is called the **accumulated value.**
- A €1 in, say, 20 years, will be worth less in terms of the goods and service it can buy then as compared with today; this is called the **present or discounted value**.

It is therefore important to understand, what is called, the **time value of money**, in particular the accumulated and discounted value of a sum of money.

13.2 Inflation and Deflation

Inflation is the rate of increase in the price of an average basket of goods and services used by the average consumer, over a period of time. The most frequently quoted rate of inflation is the annual inflation rate, i.e., the increase in the price of goods and services over the preceding 12 months.

However, it is possible for the price of goods and services to fall, in which case the rate of decline in the price of goods and services over a period is referred to as **deflation**.

13.2.1 Consumer Price Index – All Items

Although we can sometimes talk about inflation in relation to one item for example, house prices, or a small group of items, the term is usually used to describe the general increase in prices of those goods and services which make up the *Consumer Price Index - All Items* (CPI).

Every month, the *Central Statistics Office* (CSO) issues a statistical release which publishes the most recent CPI value. One such index starts with a value of 100 in November 1996. This can be obtained from www.cso.ie. For example, the index values over the period 2009 to 2023 are:

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2009	145.3	144.7	**144.7**	143.6	142.9	142.5	141.4	141.9	141.4	141.1	141.0	140.3
2010	139.5	140.1	**140.2**	140.6	141.3	141.2	141.2	142.2	142.0	142.1	141.9	142.2
2011	141.9	143.1	144.4	145.0	145.1	145.0	144.9	145.2	145.6	146.1	146.1	**145.7**
2012	144.9	146.2	147.7	147.7	147.7	147.5	147.3	148.1	147.9	147.9	147.3	**147.4**
2013	146.7	147.8	148.5	148.5	148.3	148.4	148.3	148.4	148.2	148	147.7	147.7
2014	146.9	147.8	148.7	148.8	148.8	149.0	148.7	149.0	148.7	148.2	147.9	147.3
2015	146.1	147.0	147.9	147.8	148.4	148.8	148.4	149.0	148.4	147.9	147.5	147.4
2016	146.2	146.8	147.4	147.7	148.5	149.5	149.1	148.8	148.2	147.6	147.5	147.4
2017	146.7	147.6	148.5	149.1	148.7	148.8	148.9	149.5	148.6	148.4	148.2	148.0
2018	147.0	148.2	148.7	148.5	149.4	149.5	150.0	150.4	150.0	149.7	149.1	149.0
2019	148.1	149.2	150.3	150.9	150.8	151.1	150.8	151.5	151.2	150.9	150.6	150.9
2020	150.0	150.8	151.4	150.8	150.0	150.6	150.2	150.0	149.5	148.6	149.0	149.4
2021	149.7	150.2	151.4	152.4	152.6	152.9	153.4	154.4	155.0	156.1	157.0	157.8
2022	157.1	158.5	161.6	163.1	164.5	166.7	167.4	167.7	167.7	170.4	171.0	170.7
2023	169.3	172.0	173.9	174.8	175.4	176.9	177.2	178.3	178.6	179.1	177.7	178.5

To calculate the inflation or deflation rate over a particular period, the following formula is used:

$$\left(\frac{\text{CPI Index}^{\text{End Period}}}{\text{CPI Index}^{\text{Start Period}}} - 1 \right) \text{X } 100\%$$

If the answer is positive, it's inflation. If it's negative, it's deflation.

So, for example, over the period December 2011 to December 2012:

$$\left(\frac{147.4}{145.7} - 1 \right) \text{X } 100\% \qquad = +1.16\%$$

So, the rate of **inflation** over this period was 1.16%.

Over the period March 2009 to March 2010:

$$\left(\frac{140.2}{144.7} - 1 \right) \text{X } 100\% \qquad = -3.1\%$$

So, over the period March 2009 to March 2010 there was **deflation** of 3.1%, i.e., the average price of goods and services measured by the CPI (All Items) *fell* by 3.1% over this period.

13.2.2 Allowing for Inflation

So far, we have looked at inflation from a historic perspective.

Inflation is more likely to occur over the longer term, than deflation, as some level of inflation is usually a sign of healthy economic growth. Deflation, on the other hand, is typically a sign of economic recession, when demand for goods and services in the economy falls.

If we were to assume that inflation would average 2% pa over the next 20 years, this table shows two figures:

2% pa inflation assumed

After	Projected purchasing power in the future of €1,000 of 2024 money	Sum needed in the future to provide the same purchasing power as €1,000 did in 2024
5 years	€906	€1,104
10 years	€820	€1,219
15 years	€743	€1,346
20 years	€673	€1,486
25 years	€610	€1,641

Most people would consider 2% pa to be a low inflation rate.

Yet the impact of this very modest inflation rate on the future purchasing power of €1,000 is striking ... after 10 years €1,000 will only buy 82% of the average basket of goods and services it would buy today. Just to keep pace with inflation, the €1,000 would need to have grown to €1,219.

As far as providing financial advice to clients is concerned, the above figures make it clear that it is prudent to allow for some level of future inflation in financial planning:

- **Life and Serious Illness cover needs to be regularly increased to maintain its real value**.

  For example, €10,000 of life assurance cover effected in June 2012, if not increased in the meantime, would only provide about 88.5% of the real buying power protection in June 2022 that it provided when the policy was first effected, based on inflation over the past 10 years (which has been very low).
  Many life assurance protection policies now offer an indexation option, where the cover is increased each year at a fixed rate, or in line with inflation, without fresh evidence of good health being required. The contribution will also increase, usually faster than the rate of increase in cover.

- **Allowance should be made for inflation and increases in earnings, in assessing future financial needs**.

  For example, salary and wage rises increase the level of life assurance cover required to replace earned income on death.

- Finally**, inflation has a significant effect on savers and investors**. Most savers and investors will want, as a minimum objective, to at least maintain the real (i.e., after allowing for inflation) value of their accumulated savings and investments, as otherwise its real value, in terms of purchasing power, will decline.

  In effect, savers and investors need to obtain a real investment return, i.e., a return over and above the ongoing inflation rate.

> If inflation over the year was, say, 2%, investors would need to obtain a return of 4% over that year, if they wanted to achieve a 'real' return on their savings and investments of 2% over that year.

13.3 Compound Interest

13.3.1 Overview

Having looked at the impact of inflation over the longer term, it is obvious that €1,000 in 10 years' time will not likely buy the same level of goods and services than it can buy today. We would expect €1,000 in 10 years' time to buy less than it can today.

Therefore if 100 people were offered the choice of either getting €1,000 today or €1,000 in 10 years' time, there would be no prizes for guessing that 100% of people would opt for €1,000 today!

Therefore, in considering the value of money we have to consider the impact of compound interest or the time value of money, in two different ways:

- **Accumulation**; and
- **Discounting**.

These are two sides of the same **compound interest** coin.

13.3.2 Accumulation

When we refer to a 5.75% pa interest rate, for example, we mean that €1,000 invested will earn €57.50 interest paid at the end of the year. Interest is like rent paid for the use of money.

So, after one year, we would expect €1,000 to have grown to €1,057.50. The €57.50 interest is added to the capital to become €1,057.50 capital for the following year.

If this sum is then left for a further year, at a 5.75% interest rate, then at the end of the second year 5.75% interest is added to the €1,057.50 capital to give interest for that year of €60.81, and a new capital balance of € €1,118.31. The extra €3.31 interest in year 2 over the first year is the *interest on the interest***.** This is the effect of compound interest.

The formula for accumulating €1,000 at an interest rate of 5.75% pa, is:

Accumulated value at 5.75% pa of €1,000 invested for N years:

$$\text{€}1{,}000 \times (1.0575)^{\wedge\,(N)}$$

Some calculators have a $y^{\wedge x}$ button, which you can use to work out this calculation.

Example #1

If €1,000 is invested at 5.75% pa over 10 years, what will it have accumulated to at the end of the 10 years?

The answer is:

$$\text{€}1{,}000 \times (1.0575)^{\wedge(10)} = \text{€}1{,}749.05$$

This table shows the accumulated value of €1,000 at five yearly intervals:

After	Accumulated value of €1,000…		
	…at 2% pa	…at 3% pa	…at 5.75% pa
5 years	€1,104	€1,159	€1,323
10 years	€1,219	€1,344	€1,749
15 years	€1,346	€1,558	€2,313
20 years	€1,486	€1,806	€3,059
25 years	€1,641	€2,094	€4,046

Sometimes we want to approach things from the other way... i.e., what amount needs to be invested now to accumulate to a particular lump sum at a certain time in the future.

Example #2

What lump sum needs to be invested today at, say, 3% pa, to accumulate to €50,000 in 20 years?

Using the table above we know that assuming a growth level of 3% per annum over 20 years that €1,000 will be worth €1,806. So, the factor we would use to work out a required figure is 1.806 in this case.

Lump sum to be invested to day = €50,000 / 1.806 = **€27,685**.

So, assuming 3% pa interest is earned, €27,685 invested now would accumulate to €50,000 in 20 years, i.e.:

€27685 x 1.806 = €50,000

13.3.3 Discounting

Discounting is a way of expressing the value of a sum of money payable in the future, in terms of its value today, i.e., its **present value.** It is the inverse or opposite of accumulation.

Therefore, the formula for calculating the present value, at say 3% pa of €1,000 payable after N years is:

Present value at 3% pa of €1,000 payable after N years: **€1,000/(1.03) ^ (N)**

This table shows the **present value** of €1,000 payable at certain durations, i.e., these factors are simply the inverse of the equivalent accumulating factors, so that for example while the accumulated value of €1,000 after 5 years at 3% pa is €1,159, the discounted or present value at 3% pa of €1,000 pa payable after 5 years is:

€1,000/€1.159 = €863

€1,000 payable after	Present value today…		
	…at 2% pa	…at 3% pa	…at 5.75% pa
5 years	€906	€863	€756
10 years	€820	€744	€572
15 years	€743	€642	€432
20 years	€673	€554	€327
25 years	€610	€478	€247

Tables showing the accumulation and discounting factors at different rates and at yearly durations from one year to 30years are shown at the end of this Chapter.

Example

Which would you choose if offered:

1. €10,000 in 5 years' time.
   OR
2. €20,000 in 10 years' time.

Which is the more valuable in terms of today's money, i.e. compare the two present values?

Let's say we assume a 3% pa interest rate.

- Present value of €10,000 in 5 years' time = 10,000 x 0.863= €8630.

- Present value of €20,000 in 10 years' time = 20,000 x 0.744= **€14880**

So, assuming a 3% discount rate, €20,000 in 10 years' time is more valuable than €10,000 in five years' time, because it has a much higher present or discounted value.

13.4 Reduction in Yield (RIY)

The term **reduction in yield** or **RIY** is the term used to describe a means of expressing the impact of all anticipated charges in a savings, investment or pension policy over a period of time, in terms of a reduction in the yield or return that would otherwise have been provided if the policy carried no charges.

Example

Take a unit linked investment bond.

If we assumed an investment return before charges of, say, 5.75% pa, then if the bond had a reduction in yield of, say, 1.5% pa over five years, then the projected return, net of all charges, provided by the bond after five years is 4.25% pa, in this example.

Disclosure Notices for savings, investment and pension policies must show the projected reduction in yield at particular durations.

13.4.1 Comparing RIYs

A savings plan or unit linked bond with the lowest projected RIY over a given term isn't necessarily guaranteed to have the lowest charges over that period for the following reasons:

All other things being equal, out of a group of similar competing savings plan or investment bonds, the policy with the lowest projected RIY over a specified period of time is likely to have the lowest charges over that period.

- Some policies may have an ability to increase charges in the future; for example, an annual fund charge may be 1% pa today, but a life company may be able to increase that charge in the future.

  Therefore, a projected RIY calculated assuming a 1% pa annual fund charge continues unchanged for the specified period, may be invalidated later by an increase in the level of the annual fund charge.

- The saver or investor might encash the policy earlier than the anticipated term.

  A different projected RIY may apply at shorter durations, so that, depending on the nature and incidence of the charging structure used, in the example below Plan A might be more expensive over a shorter term even though it has a lower projected RIY over 25 years.

Projected RIY of two competing savings plans

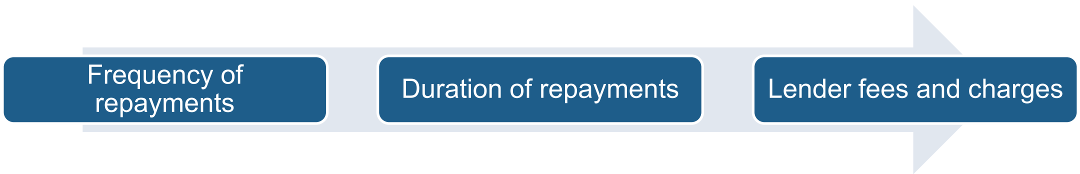
Term	Plan A	Plan B
10 years	2.4% pa	2.0% pa
20 years	2.0% pa	1.9% pa
25 years	1.6% pa	1.8% pa

In the above example, comparing RIYs over 25 years would suggest that Plan A has lower charges than Plan B.

However, if the plan were to be drawn on earlier than expected, for example after 10 years, Plan B would have lower charges than Plan A over the that period.

13.5 APR

The term APR is used to describe the equivalent or true annual rate of interest, payable annually at the end of each year, charged on a mortgage when allowance is made for:



Lenders usually show in advertisements their **typical APR**, based on a typical loan size, and do not show any other rate of interest.

The APR is a means of comparing the cost of different mortgages, by standardising the calculation of the rate of interest being charged on a mortgage.

13.6 AER

The term AER refers to the **annual equivalent rate**. It is used as a means of expressing the return quoted on a deposit account in terms of the equivalent annual rate of interest payable at the *end* of the year**.**

Comparing AERs therefore, is a means of comparing different deposit returns on the basis of a *common yardstick*. The deposit with the highest AER offers the highest return over that particular period, all other things being equal.

The Central Bank Consumer Protection Code requires that any advertisement for a savings or deposit account must show the AER along with the relevant nominal interest rate quoted for any particular term, and that both rates must be given equal size and prominence.

Accumulated value of €1,000 invested now at end of year x, at the investment returns shown

After (years)	2% pa	3% pa	5.75% pa
1	€1,020	€1,030	€1,058
2	€1,040	€1,061	€1,118
3	€1,061	€1,093	€1,183
4	€1,082	€1,126	€1,251
5	€1,104	€1,159	€1,323
6	€1,126	€1,194	€1,399
7	€1,149	€1,230	€1,479
8	€1,172	€1,267	€1,564
9	€1,195	€1,305	€1,654
10	€1,219	€1,344	€1,749
11	€1,243	€1,384	€1,850
12	€1,268	€1,426	€1,956
13	€1,294	€1,469	€2,068
14	€1,319	€1,513	€2,187
15	€1,346	€1,558	€2,313
16	€1,373	€1,605	€2,446
17	€1,400	€1,653	€2,587
18	€1,428	€1,702	€2,736
19	€1,457	€1,754	€2,893
20	€1,486	€1,806	€3,059
21	€1,516	€1,860	€3,235
22	€1,546	€1,916	€3,421
23	€1,577	€1,974	€3,618
24	€1,608	€2,033	€3,826
25	€1,641	€2,094	€4,046
26	€1,673	€2,157	€4,278
27	€1,707	€2,221	€4,524
28	€1,741	€2,288	€4,785
29	€1,776	€2,357	€5,060
30	€1,811	€2,427	€5,351

Discounted value of €1,000 payable at end of year x, at the investment returns shown

Payable in (years)	2% pa	3% pa	5.75% pa
1	€980	€971	€946
2	€961	€943	€894
3	€942	€915	€846
4	€924	€888	€800
5	€906	€863	€756
6	€888	€837	€715
7	€871	€813	€676
8	€853	€789	€639
9	€837	€766	€605
10	€820	€744	€572
11	€804	€722	€541
12	€788	€701	€511
13	€773	€681	€483
14	€758	€661	€457
15	€743	€642	€432
16	€728	€623	€409
17	€714	€605	€387
18	€700	€587	€366
19	€686	€570	€346
20	€673	€554	€327
21	€660	€538	€309
22	€647	€522	€292
23	€634	€507	€276
24	€622	€492	€261
25	€610	€478	€247
26	€598	€464	€234
27	€586	€450	€221
28	€574	€437	€209
29	€563	€424	€198
30	€552	€412	€187

Review

Now consider the main teaching points, which were introduced in this Chapter. They are listed below. Tick each one as you go through them.

- [ ] The time value of money
- [ ] The impact inflation can have on a client's financial needs and protection cover over time
- [ ] How to calculate the rate of inflation over a specified period, using a supplied table of Consumer Price Index values
- [ ] How to calculate the rate of deflation over a specified period, using a supplied table of Consumer Price Index values
- [ ] How to calculate a sum accumulated over a specified period at a specified rate of interest, using supplied accumulation tables
- [ ] How to calculate a sum discounted over a specified period at a specified rate of interest, using supplied discounting tables
- [ ] What each of the following terms is, and how they can be used; reduction in yield, APR and AER

Sample Questions

The answers to these questions can be found in your Study Hub.

1. Deflation is a term used to describe:

   A. a sustained fall in the price of goods and services.
   B. a sustained period of high interest rates.
   C. lack of regulation of financial services.
   D. high levels of Government borrowing.

2. If an investment product has a projected gross return, before charges, of 4.5% pa and a projected RIY of 1.2%, what is the projected return of this product AFTER allowing for charges?

   A. 1.2% p.a.
   B. 3.3% p.a.
   C. 4.5% p.a.
   D. 5.7% p.a.

3. The term to describe the true annual rate of interest payable on a deposit is the:

   A. AER.
   B. RIY.
   C. IRR.
   D. RAE.

4. If inflation runs at 3% p.a. over the next nine years, what will be the value of €1,000 in nine years' time in terms of today's purchasing power of €1,000?

   A. €744
   B. €766
   C. €789
   D. €1,000

How well do you know your textbook?

Chapter 1

- What are the five main types of personal financial needs a typical consumer might have at different times in their life?
- What is the key difference between earned and unearned income?

Chapter 2

- What is the key difference between a Term Assurance and a Convertible Term Assurance policy?
- How does Guaranteed Whole of Life cover differ from Unit Linked Whole of Life cover?

Chapter 3

- What is the difference between **standalone** and **accelerated** Serious Illness cover?
- What is the major limitation usually placed on IP benefit payments?

Chapter 4

- What types of regular income might become payable to dependents, following the death of an individual who was an income earner?
- What types of regular income might become payable to an individual if they fall ill and become unable to work for a prolonged period?

Chapter 5

- If a person died **intestate**, leaving a surviving spouse and two children, what minimum share of the deceased's estate are their two children entitled to under the Succession Act?
- If a person died **testate**, leaving a surviving spouse and two children, what minimum share of the deceased's estate are their two children entitled to under the Succession Act?

Chapter 6

- What is the difference between a **partnership** and a **private limited company** in terms of the liability of the participators for the debts of the business?
- In the case of a four-person partnership, how many policies would be needed if Partnership Insurance were to be arranged on all partners on a *life of another* basis?

Chapter 7

- If Mortgage Protection cover is said to be **'interest rate sensitive'**, what does this mean?
- In what circumstances might a Whole of Life cover be a more suitable option for a client than Convertible Term Assurance?

Chapter 8

- In which circumstances might **exit tax** be charged to a unit linked investment bond?
- What is the **counterparty risk** for an investor which may be present in a Tracker Bond?

Chapter 9

- What is the **projected breakeven point** in a unit linked savings plan?
- What is the recommended minimum **'emergency fund'** a consumer should have readily available for unforeseen circumstances?

Chapter 10

- Below which level of income is USC not charged in 2024?
- What is the **minimum** age at which a client can potentially qualify for the income tax exemption on his or her income?

Chapter 11

- What's the difference between **medical** and **financial** underwriting?
- What information could an underwriter use to decide on what terms to accept or reject a proposal?
- How frequently must insurers issue a statement of value?
- What piece of legislation removed the need for insurable interest?

Chapter 12

- Why does a life company need to check for non-disclosure of relevant information, when processing a death benefit claim?
- Why does a life company have to check that it is paying out a benefit to the right person?

Chapter 13

- If the CPI one year ago was 145.7 and today it is 147.4, what was the inflation rate over the last year?
- If an investor invests €30,000 now at 3% pa, what will its **accumulated value** be in 17 years' time?
- If an investor expects a fund of €30,000 to emerge from a savings plan in 10 years, what is the **present value** of this sum, using a discount rate of 3% pa?

Are you ready for your exam?

01

Do you understand the exam format?

Familiarise yourself with the structure and requirements of the exam. Understand how many questions you'll need to answer, the time limit, and any specific instructions or scoring methods.

02

Have you covered the full course material?

Have you read and understood the full textbook? Have you used the additional supplementary study resources available in your online Study Hub (pre-recorded videos, microlearning webinars, exam preparation masterclass recording)?

03

Have you created a revision plan?

Develop a study plan that outlines your exam preparation strategy. Break down your study sessions into manageable chunks and allocate time for each topic or chapter. Ensure you have sufficient time to review all the relevant material before the exam.

04

Practice sample questions

Use the sample questions related to each chapter. This will help you become familiar with the types of questions typically asked and allow you to practise applying your knowledge. Time yourself during these practice sessions to get used to working within the exam time constraints.

05

Have you used the "Take a Test" facility?

Test yourself by answering practice questions without referring to your study materials under exam conditions. This will help reinforce your knowledge and identify any remaining gaps you need to address.

06

Have you familiarised yourself with the Online User Guide and Exam Regulations, which can be found in your Study Hub?

This will help you become familiar with the online exam environment and the rules that need to be followed.

07

Have you checked your computer set up and broadband speed and stability in preparation for your online exam?

Please consult the Online Exam User Guide for further information regarding system requirements. This will help ensure your exam runs smoothly.

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